

In Focus

A briefing from the Civil Aviation Authority

April 2013

Help us make London's airports better for passengers

Economic regulation at Heathrow, Gatwick and Stansted

The CAA's role

The Civil Aviation Authority exists to protect the public. We do that by making sure the aviation sector meets the highest standards of safety; upholding consumers' legal rights when airlines do not; and protecting them if travel companies cease trading.

And we act to protect consumers when market competition fails.

One part of this is in regulating those airports that are not constrained by competition. In doing this, we seek to set service levels that meet the needs of airport users at an efficient cost, but still enabling continued investment to build modern facilities for the passengers and the economy of the future.

Late last year the Civil Aviation Act 2012 became law. The Act fundamentally changes the way the CAA will regulate airports in future, giving us the power to grant airports economic licences, which brings us up-to-date and in line with other big economic regulators like Ofgem and Ofcom.

Following the Act's Royal Assent, we are now into the process of setting out how we will use the new powers it gave us to regulate the operators of Heathrow, Gatwick and Stansted airports from April 2014, when the present set of controls expire. The CAA is now seeking your views on our initial proposals.

Good passenger service is delivered by airports and airlines working together, alongside the many other companies that operate at an airport (such as groundhandlers, fuel suppliers, retailers, and car park operators). The CAA aims to carry out its work in a way that builds up the network of relationships between these companies, so that the commercial offering can evolve flexibly, in users' interests.

Since our last airport price control review, the CAA has created a Consumer Panel to advise it. The Panel's expert members have provided a robust challenge to the CAA, to make sure that we are really focusing on what matters to end-users. We are grateful for the Panel's support in this work.

London's airports are not the same so 'one-size-fits-all' regulation is not in passengers' interests

We believe each of these airports has a market position that warrants continued regulation by the CAA after April 2014. The CAA regrets that this is the case, since fully effective competition would be likely to be better for passengers. However, and in spite of the airports now being in separate ownership, we do not see effective competition developing over the next five years. The main reason for this is the shortage of airport capacity, which means airlines that feel they are not getting a good deal often have no commercially viable options to switch to a different airport.

So the CAA is not making proposals to deregulate – but we will tailor regulation more closely to individual needs. The three airports we regulate are very different. Heathrow is the busiest two-runway airport in the world, the UK's major hub airport, operating at full capacity, and catering for a large share of long-haul, business, and transfer passengers. Gatwick, the UK's second largest airport and the busiest single runway in the world, is also operating near full capacity, especially in the summer peak and morning peaks. It caters for a broad array of airline business models: long-haul, low cost, charter and regional. At Stansted 9 out of 10 passengers fly with low cost carriers, and there is spare capacity except at peak times.

Market conditions vary across the three airports: Heathrow is more insulated from competitive threats than Gatwick, which in turn faces less competitive pressure than Stansted.

Passenger needs at these airports are of course not the same. Business passengers tend to have a different set of priorities to leisure passengers; long-haul is different to short-haul and so on. Cargo users are different again. However, our extensive passenger research does show some common themes. Although there is a high level of satisfaction in airport facilities, the importance of cost to passengers stands out, especially in challenging economic times. So does the importance of the airport's response when things go wrong and passengers experience disruption, as they have in recent years, because of bad weather, industrial action and other events.

Given these differences, a one-size-fits-all approach to regulation cannot protect users and enhance their airport experience as much as a more flexible approach. Under the new Civil Aviation Act 2012, Parliament has granted the CAA a new set of flexible powers that enable us to tailor regulation to suit the specifics of each airport and the needs of their users. For the first time, from April 2014 we will have a new licensing system for the regulated airports. We have been in discussions with stakeholders for over two years as to how best to develop it.

The Act gives us a clear overarching duty: to ensure we further the interests of passengers and those who own cargo.

Using our new powers, we have given particular attention to the individual circumstances of each airport in designing our proposals. Benchmarking suggests that Heathrow and Stansted's prices are high relative to similar airports, which is less the case at Gatwick. Similarly, our proposals for cost-of-capital vary between the airports, reflecting the differing levels of risk.

We have a clear strategy: to base our regulation on the degree of market power each airport holds, and each airport's individual case - to ensure we only regulate where necessary to protect users, and do not stifle innovation and competition.

Heathrow: an evolution of the current regulatory model

Competition faced by Heathrow Airport is quite limited, and its degree of market power the strongest of the three airports. Our proposals are to continue with our standard model of regulation, based on a Regulatory Asset Base (RAB), but enhance it with stronger incentives to improve efficiency.

Our proposals will see Heathrow's charges falling over the next five years in real terms, based on a cap of RPI -1.3%. Although the airport and the airlines share a vision, they fundamentally disagree on the level of operational efficiency and the size of the reward for Heathrow's capital providers. Our proposed price cap is based on extensive, independent analysis of these issues and we believe it fairly reflects the fact that Heathrow's charges have increased significantly in recent years to pay for large scale infrastructure development, while continuing to ensure passengers are provided a reasonable service at a world-class airport.

Gatwick: potential for a different approach, if the price is right

Our current view is that Gatwick Airport also has market power, although less than Heathrow. The CAA sees potential for airport-airline discussions to play an important role in the airport's future development: the diversity of airline requirements at Gatwick means there could be particular benefits here from airport and airlines working more closely together, following commercial norms seen at non-regulated airports. We therefore welcome Gatwick's initiative to make commitments to its airlines on price and service quality. However, airport commitments need to be fair and command the confidence of airlines if they are to work. As such, to ensure this new regime works to the benefit of passengers, the commitments would be supplemented with a basic licence from the CAA.

The commitments so far offered by the airport do not seem to the CAA to offer sufficient user benefit to be more effective than traditional regulation. We hope that Gatwick will revise its commitments to address the issues identified, notably by reducing the proposed price. Unless the airport makes such proposals, we expect to default to the same type of price cap that is used at the moment – with initial proposals to cap increases over the next five years at RPI +1% per year.

Stansted: moving towards deregulation

At Stansted we feel that an alternative approach is needed. Its market position is such that it has the most marginal case of the three airports in terms of whether it should be regulated. In the last five years traffic has fallen from 24 million passengers to 17 million passengers per year. Unlike the other two airports it has some spare capacity. Nevertheless, we believe it may have market power now, and we expect its market power to strengthen over the next five years, as capacity constraints in the London area tighten. It also has a strong current position in the cargo market.

There are also some key uncertainties at Stansted. It has only recently, in March 2013, been sold by BAA to Manchester Airports Group (MAG). And tightening capacity constraints will depend in part on how the UK economy performs in the coming years.

Having undertaken a detailed examination of the options, we consider that the best approach is to move away from setting a five year fixed price cap, and instead introduce a price monitoring regime.

This arrangement is aimed at ensuring that more of the discussion about airport prices and service quality moves into the commercial arena.

However, this is not deregulation, and our approach remains robust to ensure users are protected if the airport's market power strengthens.

Over the next five years, the CAA expects prices to fall in real terms at Stansted, and if this does not happen we will conduct a full investigation of the airport's position, with the threat of tighter regulation if we are not satisfied by its explanation.

A new licensing system

The government's reforms enable us to regulate with a licence. This enables much more flexibility to pre-empt or respond to events. 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 three airports.

Because we understand how important service quality during disruption is to passengers, one of the first licence conditions we will introduce will strengthen each airport's approach to operational resilience to make sure that when service is disrupted, the airport has robust plans, an effective approach to collaboration, and ensures full communication with affected passengers.

We welcome your feedback

Now that we have published our initial proposals, we are listening. We recognise that some stakeholders will approach us in line with their commercial interests. Price regulation understandably impacts on companies' commercial interests, and stakeholders often take starkly different views on whether a proposed price cap is too high or too low. However, we hope we can be united with all stakeholders in framing the conversation in terms of what matters for all of us – ensuring that airport users, both today and in the future, enjoy a positive experience.

We look forward to hearing your views on our proposals.

Iain Osborne

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Key documents and links

- 1 Summary of Heathrow's market power assessment www.caa.co.uk/CAP1026
- 2 Summary of Gatwick's market power assessment www.caa.co.uk/CAP1028
- 3 Market power assessment associated documents www.caa.co.uk/default.aspx?catid=78&page-type=90&pageid=12275
- 4 Economic regulation at Heathrow from April 2014: initial proposals www.caa.co.uk/CAP1027
- 5 Economic regulation at Gatwick from April 2014: initial proposals www.caa.co.uk/CAP1029
- 6 Economic regulation at Stansted from April 2014: initial proposals www.caa.co.uk/CAP1030
- 7 Initial proposals assessment associated documents www.caa.co.uk/default.aspx?catid=78&page-type=90&pageid=67