

Economic regulation: A review of Gatwick Airport Limited's commitments framework **Update**

CAP 1437

A large, abstract graphic composed of overlapping, semi-transparent circular and curved shapes in various shades of blue and purple, occupying the bottom half of the page.

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Contents

Contents.....	1
Executive summary	3
Chapter 1.....	6
Introduction	6
Purpose of this document.....	6
Our primary statutory duty.....	6
Wider context	7
Consultation responses.....	8
Chapter 2.....	9
Scope of the review.....	9
Overall focus of the review	9
Consultation responses.....	9
Our views	10
Conclusion	12
GAL's service quality and airport resilience.....	12
Consultation responses.....	13
Our views	14
Conclusion	15
GAL's investment performance.....	16
Consultation responses.....	17
Our views	17
Conclusion	19
GAL's relationship with airlines and other stakeholders	20
Consultation responses.....	20

Our views	21
Conclusion	22
Other issues within the proposed scope of the review	22
Consultation responses	23
Our views	24
Conclusion	24
Chapter 3.....	26
Next steps	26

Executive summary

1. In March 2016 we consulted on the scope of a mid-term review of the economic regulatory framework that we have applied to Gatwick Airport Limited (GAL) since April 2014. Rather than a price cap calculated by us the new framework is based on a set of commitments, given by GAL, which include a maximum level of airport charges over the seven years to March 2021 and a system of service quality rebates.
2. We described the review as an early ‘health check’ with the overarching aim of identifying any aspect of the new commitments-based framework that is acting against the interests of passengers. We noted that, while traffic growth has been significantly stronger than expected and that GAL has held its charges below our 2014 view of a ‘fair price’, on-time performance at Gatwick has been poor in each of the last two summers.
3. While recognising that on-time performance is influenced by the actions of a number of different parties, the combination of poor on-time performance and strong traffic growth could raise questions about whether GAL is providing sufficient capacity and whether stakeholders are working together effectively to deliver a better service for passengers. We therefore said that we expected the mid-term review to focus on three main issues:
 - GAL’s service quality and airport resilience – including how current targets were agreed, whether the system is working well, how all parties are working together within the new framework, and how passengers’ interests are taken into account;
 - GAL’s investment performance – including how the investment programme has changed since the Q6 review, how investment affects on-time performance, and how passengers’ interests are taken into account; and
 - GAL’s relationship with airlines and other stakeholders – including whether airlines have sufficient opportunities for constructive

dialogue with GAL, whether the overall framework encourages parties to work together to deliver a better service, and whether sufficient attention is given to passengers' interests.

4. In addition, we said that we expected to carry out a brief review of the bilateral contracts agreed between GAL and individual airlines. We also expected to validate GAL's calculation of the comparison between its blended price and our fair price benchmark, and to consider the arguments for GAL to provide airlines with a forward view of expected charges for the remainder of the seven year period.
5. Most consultation responses were supportive of our overall approach and the main issues we proposed to consider. Some respondents suggested specific examples for us to consider under each of our proposed main issues.
6. There were also some suggestions to widen the scope of the review, for example to see whether the reasons for adopting the commitments framework have come to fruition or to identify aspects of the new framework that are working well. We are not minded to consider such questions at this stage, only two years into a seven year regulatory period, and instead intend to focus on identifying any aspects of the new framework that are acting against the interests of passengers and therefore might require early remedial action.
7. We have decided to retain the overarching aim and the main issues for the review as set out in the March 2016 consultation document. When considering these issues, however, we will investigate some of the examples highlighted by consultation respondents. In particular:
 - when assessing GAL's service quality and airport resilience, we will consider how exemptions from service quality rebates have been applied (both in general and specifically in relation to pier service levels); and
 - as part of our assessment of GAL's investment performance, we will examine case studies such as the postponement of the Pier 6

southern extension project and the delays in delivering the rebuilding of Pier 1 and redevelopment of Pier 5.

Chapter 1

Introduction

Purpose of this document

- 1.1 This document describes the scope of the mid-term review of the economic regulatory framework that we now apply to Gatwick Airport Limited (GAL). It follows a consultation document that we published in March 2016.¹
- 1.2 Since 2014 our regulation of GAL's charges and service quality has been based on a set of commitments given by GAL, including a maximum level of airport charges and a set of service quality rebates. Further details of the commitments, our reasons for preferring these to a formal price cap, and the current monitoring framework are set out in the consultation document.

Our primary statutory duty

- 1.3 The Civil Aviation Act 2012 ('the Act') gives us a single primary duty to carry out our economic regulation functions in a manner that we consider will *further the interests of users of air transport services*. Under the Act, users of air transport services are defined as present and future passengers and those with a right in property carried by the service i.e. cargo owners.
- 1.4 The scope of our primary duty concerns the *range, availability, continuity, cost and quality of airport operation services*. We must carry out our functions, where appropriate, in a manner that will *promote competition in the provision of airport operation services*.

¹ CAP 1387, Economic regulation: A review of Gatwick Airport Limited's commitments framework – A consultation document. Available at www.caa.co.uk/cap1387.

- 1.5 In discharging this primary duty we must also have regard to a range of other matters.² These include:
- the need to secure that GAL is able to finance its provision of airport operation services;
 - to secure that all reasonable demands for airport operation services are met;
 - to promote economy and efficiency in the provision of airport operation services;
 - the need to secure that GAL is able to take measures to reduce, control 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.

Wider context

- 1.6 Our review of the commitments framework takes place against the backdrop of the Government developing its response to the work of the Airports Commission on new runway capacity in the South-East of England. We have already published a number of documents on our proposed approach to the regulation of new runway capacity. These include a Policy Update in September 2015,³ setting out our current thinking on a range of issues, and a further Policy Update in February 2016 specifically on the treatment of planning costs associated with new runway capacity.⁴
- 1.7 The current review will focus on how the new framework is operating at present rather than its potential suitability for regulating charges and services if GAL is given permission to build a second runway. Neither does the review cover the airspace change process (including changes to

² See section 1(3) of the Act.

³ CAP 1332, Economic regulation of new runway capacity – update. Available at www.caa.co.uk/cap1332.

⁴ CAP 1372, Recovery of costs associated with obtaining planning permission for new runway capacity: policy update. Available at www.caa.co.uk/cap1372.

flight paths for aircraft landing and taking off at Gatwick), which is a separate process that is not affected by the form of economic regulation applied at Gatwick.⁵

- 1.8 As noted in our consultation document, on-time performance at Gatwick has been poor in each of the last two summers. Many factors contribute to on-time performance, and Gatwick is not the only UK airport operating at or near full capacity. We recently launched a wider programme of work on operational resilience to examine questions such as how the performance of the aviation network can be improved or optimised, how effective is the current regime, and how passengers' interests are represented?⁶ While this wider work will cover many of the underlying factors that affect punctuality at Gatwick (including the balance between greater use of capacity and greater resilience), in the mid-term review addressed in this document we are keen to consider whether any aspect of the commitments framework is making punctuality worse (or blocking potential improvements).

Consultation responses

- 1.9 We received six responses to our consultation, from GAL, the Airport Consultative Committee – Gatwick Airport ('ACC'), Monarch Airlines, Ryanair, Virgin Atlantic and the Gatwick Airport Consultative Committee ('GATCOM').
- 1.10 These responses are available on the CAA's website.⁷ The most relevant points made in the responses are summarised in each section of Chapter 2.

⁵ For more information see <http://www.caa.co.uk/Commercial-industry/Airspace/Airspace-change/Airspace-Change/>.

⁶ For more details, see CAP 1420, Operating resilience of the UK's aviation infrastructure: A request for information. Available at www.caa.co.uk/cap1420.

⁷ See www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Economic-licensing-of-Gatwick-airport/.

Chapter 2

Scope of the review

Overall focus of the review

- 2.1 We described our proposed approach to the review as an early 'health check' on a new regulatory framework, with the aim of identifying any aspect of the new framework that is acting against the interests of passengers.
- 2.2 Reflecting the poor on-time performance experienced at Gatwick in each of the last two summers, the greater flexibility that GAL now has under the commitments framework to change its investment plans and the importance under a lighter touch regulatory framework of GAL maintaining a constructive relationship with airlines and other key stakeholders, we proposed that the review should focus on three main issues:
- GAL's service quality and airport resilience;
 - GAL's investment performance; and
 - GAL's relationship with airlines and other stakeholders.

Consultation responses

- 2.3 There was general support for the three main issues that we identified and for the focus on on-time performance. The main objection to our overall approach was from Ryanair, which argued that the review should be terminated as it is founded on the 'false hypothesis' that GAL is responsible for poor on-time performance.
- 2.4 Several respondents made suggestions for additional items that should be included in the review, as well as our proposed three main issues:
- both the ACC and Virgin Atlantic argued for greater transparency over GAL's shadow regulatory asset base (RAB);
 - GAL suggested that the review should also identify aspects of the new framework that are working well for passengers in order to

update our assessment of the actual benefits which this form of regulation can deliver. And Virgin Atlantic suggested an assessment of whether the reasons for accepting GAL's commitments rather than implementing a RAB-based price cap have actually come to fruition;⁸

- Monarch Airlines said that we should also carry out an analysis of each airline's cost base (with or without bilateral contracts) to understand and confirm that a fair competitive environment exists; and
- GATCOM suggested that we should investigate differences in the way that GAL and the CAA measure on-time performance so that there can be an accurate picture of performance over the remainder of the commitments period.

Our views

2.5 We are not persuaded by Ryanair's argument that we should terminate the review. We already recognise that on-time performance is affected by many different factors and, as noted above, we are carrying out wider work on operational resilience. Nevertheless, poor on-time performance has had a significantly adverse effect on passengers at Gatwick in each of the last two summers. So we believe it is important to consider whether any aspect of the commitments framework has made the situation worse. And, as discussed in later sections, our review will consider other issues and not just on-time performance.

2.6 Neither are we persuaded that we should widen the review to consider the possible positive impacts of the commitments framework. It will be important to examine these issues at a later stage, for example when we start to consider how GAL should be regulated after the end of the current regulatory period. At this early stage in the life of the new regulatory framework, however, our priority will be to identify any aspects that are

⁸ Virgin Atlantic referred to reasons including a better framework to diversify the service offering, whether innovation and diversity have truly started to emerge, the expected pricing profile over seven years, and outturn operating and capital expenditure.

acting against the interests of passengers and therefore might require early remedial action.

2.7 Similarly, we are not persuaded by the arguments for including other additional issues, as suggested by some consultation respondents:

- neither the ACC nor Virgin Atlantic provided a strong argument why publishing GAL's shadow RAB (or other regulatory building blocks) would help to further the interests of passengers at Gatwick. The fair price benchmark that we calculated in 2014 already provides airlines with a basis for assessing whether GAL's proposed charges are reasonable during the current regulatory period.⁹ Furthermore, GAL's consultations on its capital investment programme already provide airlines with a lot of information on actual and proposed levels of capital expenditure (capex) by GAL;
- while we will be carrying out a brief review of GAL's current bilateral contracts with airlines (see below), we only expect to undertake a more detailed analysis if there are clear indications of significant and unwarranted differences either between the contracts themselves or between GAL's willingness to negotiate with individual airlines. We note that we would normally expect to see some variations between the terms in individual contracts, reflecting both differences in the contracts themselves (length of contract, growth targets or other airline commitments, services required, etc) and also differences that reflect the success of the negotiating strategies and teams used by individual airlines; and
- we are already aware of the discrepancy between GAL and CAA data on on-time performance which reflects, among other things, differences in the treatment of taxi times. These differences may be addressed, to some extent at least, by changes that we may make next year to update our measurement of punctuality across all reporting airports. As this issue is not directly related to the

⁹ This benchmark will not reflect the impact of traffic growth being stronger than we expected at the time of the Q6 review. However, we stated in 2014 that we would not normally regard this as a reason for expecting GAL to set charges below our fair price benchmark.

commitments framework, we do not intend to consider it as part of the current review.

Conclusion

2.8 Having considered the consultation responses, we remain of the view that:

- the review should have a narrow focus on identifying any aspect of the commitments framework that is acting against passengers' interests; and
- it should focus on the three main issues of GAL's service quality and airport resilience, GAL's investment performance, and GAL's relationship with airlines and other stakeholders. More detailed comments on each of these issues are set out in the following sections.

GAL's service quality and airport resilience

2.9 In relation to service quality and airport resilience we noted, in our consultation document, that on-time performance is important for passengers but can be significantly affected by the actions of a number of different parties. GAL's commitments include a system of service quality rebates payable if it misses certain targets (the 'Core Service Standards'). However, these are focussed on standards that are mainly under GAL's control and therefore do not include on-time performance.

2.10 For the current review we proposed to focus on how the commitments framework affects service quality and airport resilience – expecting to cover issues including:

- how the current service quality targets and rebates were agreed, whether they are working well, and any possible risk of distortions especially in relation to on-time performance;
- how all parties are working within the new framework to deliver an appropriate level of service quality and performance; and

- how passengers' interests are taken into account.

Consultation responses

- 2.11 Most consultation respondents agreed with the proposed focus on service quality and airport resilience, with many comments addressing on-time performance. There was some concern that our proposed approach (and the list of issues we expected to cover) did not pay enough attention to on-time performance and that it is important that resilience is assessed robustly in the interests of passengers. Equally, several respondents acknowledged that the current review is not the right place for us to carry out a full assessment of resilience issues at Gatwick. And GAL stressed that the commitments framework is only relevant to the issue of on-time performance to the extent that the framework affects, or could affect, punctuality outcomes.
- 2.12 There were also a number of specific suggestions for issues to be considered within this part of the review, including:
- the ACC suggested that we consider whether the service quality regime is providing any perverse incentives;
 - both the ACC and Monarch Airlines raised the issue of exemptions from service quality rebates. One specific concern is that limited pier capacity at Gatwick has led to airlines requesting off-pier operations in order to support punctuality and provide resilience for their own operations,¹⁰ but these services are then excluded from reported pier service level (PSL) performance statistics and this masks the extent to which GAL is missing the PSL target set out in the Core Service Standards;¹¹
 - airlines also stated that GAL has increased the number of requests for exemptions from service quality rebates and some suggested

¹⁰ Airlines argue that it is better for them to plan in advance which services will use remote stands, rather than face the uncertainty that incoming aircraft may be forced to wait for a stand, allocated a stand in a different part of the airport, or diverted to a remote stand at short notice.

¹¹ The ACC provided some calculations which suggest that actual pier service levels in June to September 2015 were 83.1% and 92.4% in the North and South terminals respectively, compared with Core Service Standards targets of 95% and reported performance levels above 96%.

that this could be linked to the structure adopted for GAL staff bonuses;

- several respondents suggested that our review should cover the capacity declaration process¹² at Gatwick and how passengers' interests are represented; and
- Monarch Airlines suggested that the review should cover the mechanisms used to calculate service quality metrics and rebates, and the accuracy of these calculations. It also highlighted 'the infrastructure constraint created by GAL', and concerns regarding GAL's asset maintenance.

Our views

2.13 We agree that on-time performance is important for passengers, and we certainly expect it to figure prominently in our review of GAL's service quality and airport resilience (as well as GAL's investment performance – see below). As noted in Chapter 1, however, we are already carrying out wider work on operational resilience, and for our mid-term review of the commitments framework we will focus on whether any aspect of the new framework is making the problems associated with poor on-time performance worse. For similar reasons, we expect the capacity declaration process to be considered as part of our wider work, rather than as part of our review of the commitments framework.

2.14 We also agree that GAL's use of exemptions should be covered by our review, both in relation to pier service levels and more generally. If current practice is masking a failure to meet agreed service quality targets then this could mean that airlines are not receiving rebates that they might otherwise have been entitled to.¹³ Equally, if investment projects or maintenance activities are being delayed, because of disagreements over

¹² This is the process of determining, for each winter or summer season, the number of take-off and landing slots that will be available during each hour.

¹³ As well as affecting rebate payments, unreliable reporting of GAL's compliance with service quality targets may have implications for the monitoring of GAL's compliance with its commitments, in particular its investment commitment 'to maintain and develop the infrastructure of the airport to enable the Core Service Standards to be met'.

exemptions requested by GAL, this could have an adverse effect on passengers' interests.

- 2.15 If some aspect of the current system of service quality rebates is creating perverse incentives, or otherwise distorting GAL's behaviour, then we would certainly expect to consider this as part of our review. In such cases, we will need to consider the extent to which any problems are attributable to the commitments framework and whether a different regulatory framework (for example with a more interventionist role for us) might in practice provide either a better or a worse outcome for passengers.
- 2.16 At present, we do not expect to consider the role of GAL's bonus structure or similar internal issues. The question of how GAL motivates its staff in response to service quality incentives is not obviously linked to the commitments framework or a switch away from a RAB-based price cap. Instead, we will focus on questions such as whether our lighter touch regulation of GAL has created loopholes or distortions that would not have existed under the previous regulatory framework.
- 2.17 Neither do we expect our review to consider the accuracy of the mechanisms used to calculate service quality rebates. As noted in our consultation document, we have been carrying out a separate audit of service quality regulation at both Heathrow and Gatwick. The results have now been shared with both the airport operators and airlines and we expect to publish the final report later this year.

Conclusion

- 2.18 We expect service quality and airport resilience to be one of the main issues for the mid-term review. As stated in our consultation document, we expect to address questions including how the current service quality rebates were agreed and whether they are working well or causing any distortions, how the parties are working together within the new framework and how passengers' interests are taken into account.

- 2.19 We fully expect this part of our review to consider issues related to on-time performance, as well as other aspects of service quality. However, our focus will be on whether any aspect of the commitments framework is making punctuality worse (or blocking potential improvements), rather than seeking to address all aspects of on-time performance at Gatwick.
- 2.20 In addition, we will consider how exemptions from service quality rebates have been applied (both in general and specifically in relation to pier service levels) and how this has affected passengers' interests.

GAL's investment performance

- 2.21 GAL's commitments include obligations to maintain and develop the airport infrastructure so that it can meet the Core Service Standards, and to invest at least £700 million during the seven year period. Under the new regulatory framework GAL is no longer subject to capex triggers linked to the delivery of specific investment projects.¹⁴ In principle, this provides GAL with greater flexibility to adapt its investment programme in response to changes in market conditions or new opportunities to improve services for passengers.
- 2.22 We said that, when reviewing GAL's investment performance, we would expect to consider questions such as:
- how its investment programme has changed compared with the programme we considered during the last periodic review (Q6) and the main reasons for this;
 - whether there is any evidence that GAL's investment decisions have affected on-time performance (or are likely to do so in future); and
 - how passengers' interests are taken into account.

¹⁴ In contrast, Heathrow Airport Limited's price cap still includes capex triggers. Further, the governance framework for investment at Heathrow now provides for separate categories of 'core' and 'development' capex, with transitions from development to core categories overseen by a Capital Portfolio Board, and further scrutiny provided by an Independent Funds Surveyor.

Consultation responses

- 2.23 There was general support for reviewing GAL's investment performance as part of our review. GAL highlighted that it currently projects investment expenditure of £1.6 billion over the seven year period, which it states is £152 million higher than the forecast we made during the Q6 price review.
- 2.24 The ACC argued that we should consider GAL's plans for future investment, how it will support the delivery of on-time performance and increased capacity, and whether the current framework adequately incentivises GAL to deliver the right level of investment and to deliver it on schedule.
- 2.25 Airline respondents also identified a number specific issues that our review should cover, including:
- delays in delivering major investment projects (including the rebuilding of Pier 1 and redevelopment of Pier 5) and also concerns that this reflects a systematic problem;
 - changes to GAL's investment programme, in particular the Pier 6 southern extension project which was initially postponed and now GAL is investigating alternative options;¹⁵
 - whether GAL prioritises retail investment above operational needs; and
 - whether there should be financial penalties for the late delivery of investment.

Our views

- 2.26 The consultation responses raise a number of points that we agree are relevant. It will be important for us to examine how GAL's investment programme has changed over time, both since the Q6 review and as the

¹⁵ This project was intended to help GAL deliver 95% pier service levels. It was postponed as a result of the forthcoming consolidation of easyJet's services in the North Terminal (with some other airlines moving to the South Terminal), which in GAL's view meant that the requirement for additional capacity could be deferred for several years.

extent of stronger than expected traffic growth (and therefore earlier than expected need for additional capacity) became clearer.

- 2.27 We will want to understand, within the commitments framework, how likely requirements for additional capacity (or other investment projects) are recognised, how options for meeting the requirements are identified, how a preferred option is selected and approved, the role of airlines (and passengers) in the overall process, and whether there are any blockages that might prevent GAL from delivering required new capacity in a timely and efficient manner. And we will also want to understand the practical consequences of any delays in delivering investment, for example if this contributes to poor on-time performance or a deterioration in other aspects of service quality.
- 2.28 The Pier 6 southern extension project is likely to provide a useful case study. We note that the ACC's data (which captures all uses of remote stands, rather than excluding airline requests) suggests that GAL cannot always provide 95 per cent pier service at present, though we recognise that the situation may improve following next year's switching of some airlines between the North and South terminals.
- 2.29 In addition to low levels of pier service, a lack of airfield capacity could contribute to poor on-time performance. However, we also recognise that the Pier 6 southern extension project was not supported by airlines. We believe it will be useful therefore for us to understand the respective roles of GAL and airlines in discussions about the initial project specification, the need for additional capacity,¹⁶ the decision to postpone the project, and what work was carried out (or could have been carried out) at different stages to explore potential alternatives.
- 2.30 We also agree that it will be useful to examine cases where major investment projects have been delayed, including the Pier 1 and Pier 5 projects. We will wish to consider whether financial incentives for timely

¹⁶ During the Q6 review, for example, we note that some airlines questioned the need for such investment, arguing that pier service levels could be maintained through increased towing.

delivery, for example through capex triggers or a more tightly defined set of exemptions from service quality rebates, might have resulted in a different outcome. Our main focus will be on passengers' interests, and we note that in theory there could be cases where late delivery might be the best option (for example, if the delay has relatively little impact on passengers and where adherence to original timetable would have led to a significant increase in costs).

- 2.31 The question of how GAL prioritises investment may or may not be relevant to our review. If a decision to go ahead with commercial investments has an adverse effect on the delivery of new or enhanced aeronautical capacity, then the possible prioritisation of commercial investments could be a factor that acts against passengers' interests. But, if there is no connection between the delivery of commercial and aeronautical investments then the success or otherwise of GAL's commercial investment programme is less relevant to the current review.

Conclusion

- 2.32 GAL's investment programme will be one of the main issues we examine during our review. As set out in our consultation document, we will consider how the programme has changed since our Q6 review, how investment has affected on-time performance and how passengers' interests are taken into account. In doing this:
- we will look at both the overall investment programme and a small number of case studies, including the Pier 6 southern extension, Pier 1 rebuilding and Pier 5 redevelopment projects;
 - we will seek to understand, within the commitments framework, how GAL and airlines have worked together to recognise future challenges and to identify and implement solutions, and the extent to which a different regulatory framework might have delivered either a better or a worse outcome for passengers.
- 2.33 As well as considering how the commitments framework affects GAL's delivery of investment projects, we will also want to understand the

practical consequences for passengers of any delays or other changes to the programme, including the implications for both on-time performance and other aspects of service quality.

GAL's relationship with airlines and other stakeholders

2.34 The commitments framework provides GAL with an opportunity to forge a stronger and more responsive relationship with airlines and other stakeholders. It is important that this happens, and that GAL responds to the needs of airlines and their passengers, as the new framework envisages a lighter touch role for the CAA.

2.35 We said that we would expect the mid-term review to consider questions such as:

- whether airlines have sufficient opportunities for constructive dialogue with GAL, either individually or collectively;
- whether the overall framework is working in a way that encourages parties to work together to deliver a better service for passengers; and
- whether sufficient attention is given to passengers' interests during discussions between GAL and airlines.

Consultation responses

2.36 As with the other main issues, there was general support for examining GAL's relationship with airlines and other stakeholders as part of our review. GAL cautioned that all parties are still learning how best to operate in a new regulatory environment and that its methods of engaging with airlines are still evolving.

2.37 Several airline respondents made specific comments about GAL's consultation processes:

- the ACC raised concerns about GAL's consultations on operational issues, including a high volume of consultations with insufficient

prioritisation, and inadequate information on some significant issues;
and

- Monarch Airlines highlighted that it could be difficult for smaller airlines to devote sufficient resources to consultations, especially in view of the large number of workshops and committees. It also commented on GAL's tendency to separate operational issues from discussions of costs and the implications for charges, and a tendency to rush things through or stay at high level.

2.38 A number of the airline respondents noted our statement (originally made during the Q6 review) that if GAL can develop good relationships with airlines and the flexibilities within the regime are operating in passengers' interests, then there could be scope for a scaling back in our monitoring of the commitments. They expressed their opposition to any scaling back in our monitoring of GAL.

2.39 Monarch Airlines also stated that it would like to understand how operational excellence can be recognised within the new framework. It argued that the incentives that GAL is introducing for airlines and ground handlers need to go further, for example by applying all year round and including a broader range of measures.

Our views

2.40 Many of the comments from consultation respondents were consistent with the review that we expect to carry out. We are keen to consider any specific issues raised by stakeholders, but also to establish the overall situation and whether GAL is maintaining constructive ongoing relationships with airlines and other key stakeholders.

2.41 We have some sympathy with GAL's argument that all parties are learning how best to operate within the new framework. Nevertheless, if we concluded that certain aspects of the new framework were acting, and likely to continue acting, against the interests of passengers, then we would need to consider the case for further intervention in order to prevent (or reduce) further adverse impacts in future.

- 2.42 In the first instance, we consider that airlines should provide feedback on consultation processes directly to GAL. We understand, for example, that GAL made some changes to the most recent consultations on its capital investment programme, and that its operations consultation forum is still a relatively new innovation. We encourage airlines to discuss their concerns with GAL and subsequently with us if improvements are not forthcoming.
- 2.43 Finally, regarding the incentives that GAL has introduced for airlines and ground handlers, we note that this is a relatively new initiative and indeed one that has occurred since the introduction of the commitments framework. We welcome any initiative that is likely to lead to improved services for passengers, and look to GAL to discuss with airlines and other stakeholders the speed with which such measures should be introduced.

Conclusion

- 2.44 Consistent with the approach set out in our consultation document, we will examine GAL's relationship with airlines and other stakeholders, considering issues such as whether airlines have sufficient opportunities for constructive dialogue with GAL, whether the commitments framework encourages parties to work together to delivery better services for passengers, and whether sufficient attention is given to passengers' interests in discussions between GAL and airlines.
- 2.45 We recognise that the commitments framework is still a relatively new and evolving framework, and will focus our attention on any aspects that are likely to act against passengers' interests during the remainder of the period.

Other issues within the proposed scope of the review

- 2.46 In addition to the three main issues described above, we also said that we would:

- carry out a brief review of the bilateral contracts agreed between GAL and airlines, to assess the extent to which service quality and other provisions have been tailored to the needs of individual airlines and their passengers; and
- validate GAL's calculation of the comparison between its blended price and our fair price benchmark, and consider the arguments for GAL to provide airlines with a forward view of expected charges for the remainder of the commitments period.

2.47 We also identified several issues that we did not intend to consider in detail during the review, including our monitoring framework, operating expenditure and commercial revenues, and wider airport developments at Gatwick (including the slot declaration process).

Consultation responses

- 2.48 Several respondents (including GAL, the ACC and Virgin Atlantic) supported the review of bilateral contracts, though GAL advised that we should be mindful that these contracts are the outcome of bilateral negotiations between two commercial parties. As noted above, Monarch Airlines argued for a more thorough review, considering each airline's cost base (with or without bilateral contracts) in order to understand and confirm that a fair competitive environment exists.
- 2.49 GAL agreed that we should validate its calculation of the comparison between the blended price and our fair price benchmark. Further, the ACC, Virgin Atlantic and Monarch Airlines all argued that GAL should provide a price forecast for the remaining years of the commitments period, with the ACC suggesting that we have a responsibility to ensure that this occurs. GAL noted that it had already provided an indication of the likely rate of growth in the planned gross yield per passenger for 2017/18, and that its commitments provide a binding upper limit on the growth in airport charges during the rest of the period.

Our views

- 2.50 Our proposed brief review of the bilateral contracts agreed with GAL will provide useful information on the extent to which some of the aspirations that we had when accepting the commitments framework have been achieved in practice. But, for the reasons outlined above, we do not expect to carry out a detailed review of these contracts and the cost base of individual airlines unless there are clear indications of significant and unwarranted differences between the terms included in particular contracts.
- 2.51 We recognise the concerns expressed by airlines about the visibility of future charges. As GAL has market power, airlines cannot necessarily rely on competitive constraints to prevent future price rises. We welcome GAL's pricing below both its price commitment and our fair price benchmark during the first few years of the commitments period. However, we also recognise that this creates a potential risk that GAL could introduce very large price rises in future years (to compensate for the current under-recovery) and we would not have any immediate way of preventing this.
- 2.52 Like many businesses, airlines need to plan their services several years in advance. There could be a danger that airlines will be discouraged from introducing new or improved services that could benefit passengers because of uncertainty over future levels of airport charges (and in particular the risk of significant increases towards the end of the commitments period). We will therefore discuss with GAL possible options for providing guidance to airlines about the future level of charges during the remainder of the period.

Conclusion

- 2.53 As set out in our consultation document, we will carry out a brief review of the bilateral contracts between GAL and individual airlines, and validate GAL's comparison between its blended price and our fair price benchmark. Recognising the concerns of airlines, we will discuss with

GAL its expectations about charges during the remainder of the commitments period, and possible options for providing guidance to airlines about the future level of charges.

Chapter 3

Next steps

- 3.1 We plan to start the review in September 2016. Among other things, this will allow us to take account of emerging information on the level of on-time performance during the peak summer period, and any problems that emerge during this time.
- 3.2 We expect to hold structured meetings with key stakeholders, including GAL, the ACC and individual airlines. During these meetings we will aim to have detailed discussions of the issues set out in this document and any others that arise during the course of the review.
- 3.3 GAL has already supplied us with a number of submissions covering topics such as punctuality, service quality, investment and passenger engagement. Many of these have been also been shared with airlines (via the ACC) except where material is confidential.
- 3.4 We will be requesting additional information from GAL including a comparison between its investment programme and the capex projections that we adopted during the Q6 review, the data underpinning its comparisons of the blended price and our fair price benchmark, details of its bilateral contracts with individual airlines, information about specific investment projects, and additional information about the exemptions from service quality rebates that it has agreed with airlines.
- 3.5 Depending on any major issues arising during the review, we will aim to publish our conclusions by the end of 2016. If we recommend any changes to the current framework or specific actions for GAL and/or airlines, then we will consult on our conclusions and recommendations.