



SOME ISSUES IN AIRPORT REGULATION

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MARKET AND REGULATORY BACKGROUND



- 1986 Airports Act – relative stability
- “La rupture”
 - market: liberalisation (Europe and beyond), no frills, regional airports
 - airport ownership: increasingly private
 - regulatory developments – OFT/CC market inquiry, dedesignation review
 - Europe: liberalisation and regulation
- Processes underway
 - CAA reference to CC of Heathrow and Gatwick
 - CC market inquiry
 - DfT consideration of designation criteria and then Manchester and Stansted

PRESENTATION COVERAGE

- Issues CAA faces in regulating in a proportionate way in a changing environment
 - what we regulate – boundary between competition and regulation
 - how we regulate – developments in
 - incentivising service quality
 - dealing with high gearing
 - constructive engagement
 - Europe

WHAT WE REGULATE: CHANGING MARKET CONTEXT

- CAA price regulates 4 “designated” airports
- 16 airports with over 1 million passengers unregulated
- Regional airports
 - increasing private sector ownership
 - faster growing
 - wider range of services
 - beginnings of long haul
- Interaction with no frills airline model generated increased competition



9th June 1993

08:50 Dublin Ryanair

21:55 Dublin Ryanair

8th June 2005

06:10	Amsterdam	easyJet
06:30	Malaga	easyJet
06:45	Reus	Ryanair
07:00	Dublin	Ryanair
07:00	Nice	easyJet
07:05	Rome (CIA)	Ryanair
07:10	Pisa	Ryanair
07:20	Barcelona	easyJet
08:00	Paris (CDG)	easyJet
08:00	Palma	easyJet
09:20	Venice (Treviso)	Ryanair
09:45	Amsterdam	easyJet
12:00	Geneva	easyJet
12:25	Nimes	Ryanair
12:45	Madrid	easyJet
12:55	Basel	easyJet
13:10	Cork	Ryanair
13:25	Malaga	easyJet
13:35	Alicante	easyJet
13:45	Dublin	Aer Lingus
13:55	Cologne	easyJet
15:20	Dublin	Ryanair
15:30	Gerona	Ryanair
15:35	Amsterdam	easyJet
15:50	Berlin (SXF)	easyJet
16:35	Granada	Ryanair
17:30	Nice	easyJet
17:45	Murcia	Ryanair
17:55	Barcelona	easyJet
18:00	Bergamo	Ryanair
18:40	Shannon	Ryanair
18:55	Amsterdam	easyJet
19:05	Katowice	Wizz Air
19:10	Paris (CDG)	easyJet
19:45	Palma	easyJet
20:25	Malaga	easyJet
20:40	Knock	Aer Arann
21:10	Dublin	Ryanair

Liverpool John Lennon Airport

international scheduled services

departure board Summer Wednesday 1993 & 2005

WHAT WE REGULATE: PROCESS FOR REVIEW



- Designation for price cap control is government decision
- CAA, OFT and Transport Select Committee support review
- Two stages
 - consultation on criteria
 - degree of market power
 - adequacy of Competition Act
 - costs of regulation vs benefits
 - Government currently deliberating
 - Manchester and Stansted cases drawing on of CAA analysis and advice
 - CAA work so far in context of price control

WHAT WE REGULATE: KEY CONSIDERATIONS I

- Demand from airlines and passengers
 - passengers
 - rich CAA data
 - different segments
 - leisure
 - least time sensitive
 - most price sensitive
 - choice of origin airport but also
 - destination
 - other discretionary spending
 - airlines
 - choice of airports to serve
 - particular destinations
 - entirely different destinations
 - decisions within context of free European market

WHAT WE REGULATE: KEY CONSIDERATIONS II



- Supply by airports
 - costs significantly fixed – capital and operation
 - revenues largely variable
 - airport charges, but also
 - commercial revenues
 - difficult to price discriminate
- Implications
 - airports sensitive to passenger throughput
 - airline switching costs will be important but
 - a growing market
 - more flexibility for point to point than network carriers

WHAT WE REGULATE: CAA WORK SO FAR



- Two strands -
 - market power
 - currently
 - high level indicators – price, profitability
 - catchment analysis
 - evidence of airport-airport interaction
 - in future
 - prospective demand supply balance
 - what factors might change
 - impact of regulation
 - on airport and airline incentives
 - on development of competition
 - resulting costs

WHAT WE REGULATE: CAA FINDINGS SO FAR



- Until criteria clear CAA hasn't reached definitive views
- Evidence varies by airport but
 - passengers do travel significant distances – leisure particularly
 - significant route overlaps between airports
 - passengers use a variety of airports
 - passengers at London airports often prefer (closer) regional airports
 - all pointing to significant competition
 - on regulatory costs, particular issues at Stansted given large scale of investment relative to RAB

WHAT WE REGULATE: ISSUES ARISING

- Are airports “natural monopolies”?
- Burden of proof
 - if it ain’t broke don’t fix it?
 - how great are airline switching costs, especially given airline order pipeline?
 - what process for redesignation?
 - how much reliance can be placed on Competition Act remedies
 - can they deal with excessive pricing?
 - OFT administrative rationing?
 - prolonged processes?

HOW WE REGULATE



- Three issues
 - regulating service quality – degree of regulatory intervention
 - approach to dealing with high gearing
 - making best use of airline/airport interaction – constructive engagement

REGULATING SERVICE QUALITY



- Introduced 2003 review
 - 3 per cent of revenues at stake annually
 - metrics covering 12 aspects of service to airlines and passengers
- Proposing to retain, broaden, strengthen and provide upside
- Question
 - extensive and detailed list
 - input focussed?
 - minimum restrictions/output basis?
- Answer
 - airports deliver variety of services
 - no sensible way of defining a single output
 - dependent on other parties
 - same issue bedevils benchmarking
 - examined more output-based approach to airport delay –
 - eventually settled for more limited measure

DEALING WITH HIGH GEARING I



- CAA's position that finances of the company/companies matter for their owners and financiers
 - set out in 2003
 - reaffirmed and strengthened in recent CAA documents
- In last years bidding CAA set out
 - concerns about potential effects of high indebtedness on investment
 - need for new owners to recognise that costs and risks lay with them
 - CAA would seek to protect interests of users all within the context that
 - designated airports do not operate under licence
 - CAA therefore has no powers to enforce a ring fence, particular credit rating etc
- CAA's approach therefore conditioned by
 - (absence of) legal powers
 - clarity about its and companies' responsibilities

DEALING WITH HIGH GEARING I I



- Main elements
 - incentivisation of investment delivery (triggers)
 - effectively penalises investment deferral to financial difficulties
 - accept that could exacerbate financial distress
 - and that financial failure could result
- By spelling this out clearly CAA
 - incentivises appropriate financing in first place
 - strengthens regulator's and users' positions in event of financial distress
- Questions
 - consistency with CAA treatment of NATS?
 - continuity of service – are airports different?

CONSTRUCTIVE ENGAGEMENT

- Origins
- Aims and expectations
- Process
- Achievement

CONSTRUCTIVE ENGAGEMENT: ORIGINS

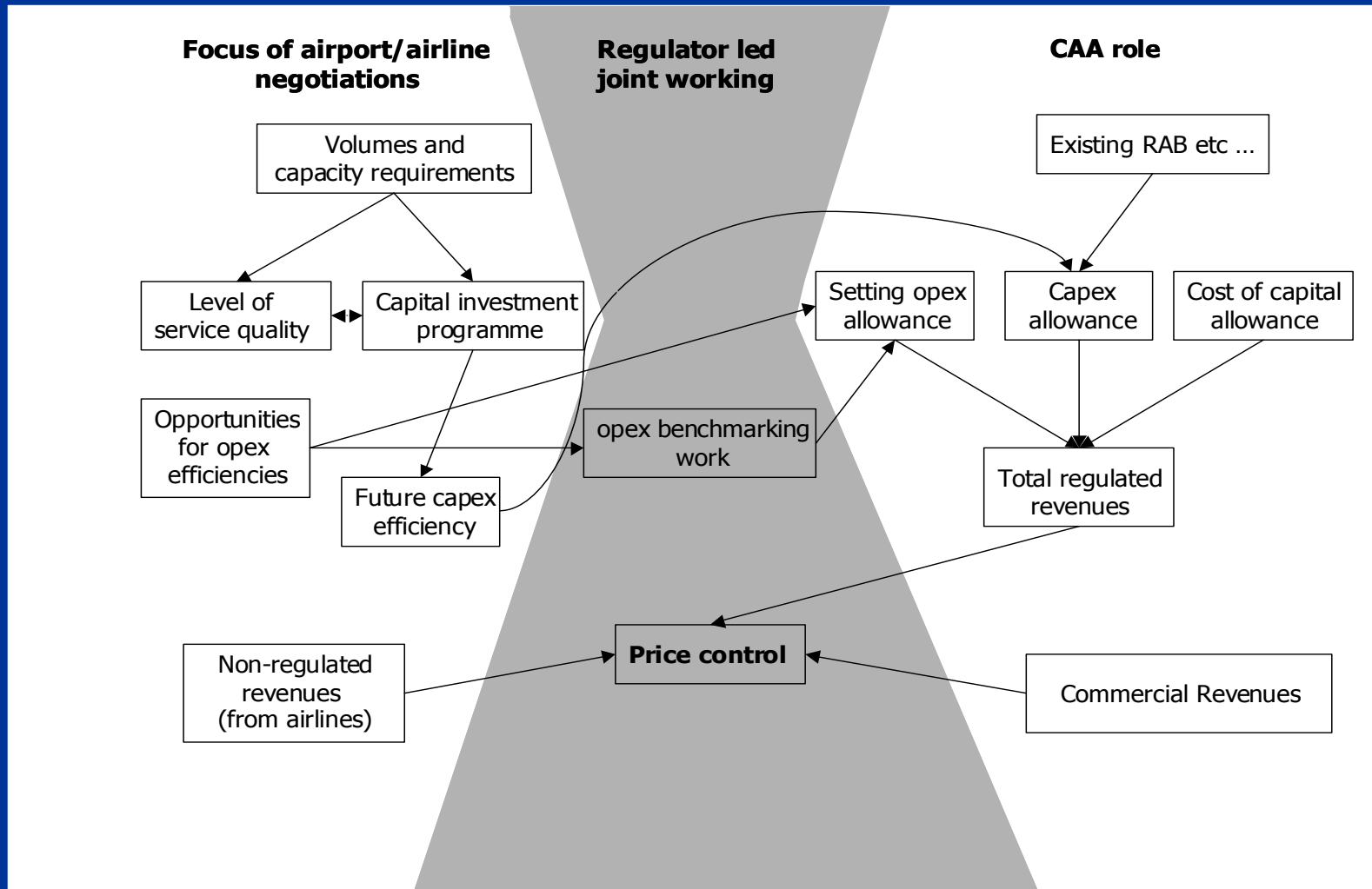
- 2004 review
 - move from declining/flat to rising prices, particularly Heathrow
 - rising investment
 - 6½% per annum real price increases at Heathrow
 - increasing airline focus on costs
 - behavioural impacts
 - influencing regulator rather than customers
 - airlines not bought in
 - adversarial
 - at odds with underlying business relationships

CONSTRUCTIVE ENGAGEMENT: AIMS AND EXPECTATIONS



- For airlines
 - airport focus on customers
 - consultation mainstreamed
 - real input into decisions
- For airports
 - greater consensus on plans and projects
 - more structured information on airline requirements
 - more recognition of realities
- For the regulator
 - improved information and inputs
 - less intrusion on commercial issues
 - a more focussed role
 - better decisions
- Overall
 - potential for agreement on key building blocks
 - better definition of areas of disagreement

CONSTRUCTIVE ENGAGEMENT: PROCESS



CONSTRUCTIVE ENGAGEMENT: STANSTED AND MANCHESTER

- Manchester - continuing
 - broader remit - opex
- Stansted - impasse
 - new investment
 - White Paper
 - regulatory incentives
 - operational issues

CONSTRUCTIVE ENGAGEMENT: ACHIEVEMENT – HEATHROW AND GATWICK



- Still continuing – end-June deadline
- Business uncertainties
 - EU/US agreement affects Heathrow/Gatwick traffic distribution
 - capex evaluation
 - Heathrow East Terminal (HET)
 - rethink at Gatwick
- Consensus on
 - base capex at Heathrow and Gatwick
 - treatment of non-regulatory charges
 - broad scope for capex efficiency
 - traffic evolution at Gatwick (pre-EU/US)
- Still to play for
 - HET etc
 - traffic at Heathrow
 - but uncertainties remain
- Longer term improvement in consultation – “quality of regulatory discourse”
- Lessons

EU AIRPORT CHARGES DIRECTIVE

- Commission proposal January 2007
- Still early days, but
 - a significant increase in regulation
 - an exiguous impact assessment
 - politically rather than objectively determined
- Moves in contrary direction to UK market trends

EU AIRPORT CHARGES DIRECTIVE



- Key elements
 - establishment of independent regulatory authority (IRA)
 - applies to airports with over 1 million passengers
 - 20 in UK
 - 144 throughout Europe
 - compulsory consultation within given timescales
 - transparency requirements
 - airports to airlines (on cost base)
 - airlines to airports (on business plans and fleet mix)
 - disputes between airports and airlines referred to IRA for binding resolution

BOURNEMOUTH AIRPORT TERMINAL BUILDING



EU AIRPORT CHARGES DIRECTIVE



- Questions:
 - is it appropriate/proportionate?
 - no clarity on objectives
 - no mention of passengers
 - scope unrelated to market power
 - dispute resolution will widen regulatory intervention
 - airline behaviours regulated
 - is it workable?
 - unmanageable consultation burden for airports/airlines
 - no criteria for dispute resolution
 - will states have resources/expertise?
 - impact on investment?
 - risks of game playing to delay investment
 - adverse effect on incentives to invest from ad hoc regulatory intervention without clear criteria

EU AIRPORT CHARGES DIRECTIVE



- UK objectives should be to
 - reduce/refine scope more in line with market power
 - depending on that
 - reduce transparency requirements
 - make consultation less prescriptive
 - set parameters for IRA's role
 - but it will be difficult!