Introduction

The CAA has requested comments from stakeholders on the slides presented on 16 September, in particular on the “Classification of regulatory approaches” slides, which the working group did not have an opportunity to discuss in detail due to time constraints. This note sets out Gatwick Airport’s comments on those slides.

High level comments

Overall we welcome the CAA seeking to bring further refinement to the consideration of alternative forms of regulation. While the work of Europe Economics was helpful in identifying different approaches to regulation, there remains much to do by the CAA, in conjunction with stakeholders, to ensure that an appropriate regulatory settlement is reached post Q5.

We agree with the general approach set out in slide 2 of considering the practicality of different regulatory approaches. Clearly, where a particular approach will be highly impractical to implement, then this should be identified, with that particular approach being discarded, at least for the time being. This is unless there are particular significant advantages of such an approach which mean that there is benefit in seeking to overcome the practical implementation issues.

We also agree that it could be useful to understand and categorise the different approaches according to i) whether they represent a change in approach from that that has been implemented previously in the UK and ii) on the basis of how suitable they are depending on the level/degree of competition present as set out in slide 3.

However, we consider that the framework set out in the slides can be improved and as such we set out a number of detailed comments below.

Detailed comments – slide 2

Practicality

This slide is titled “Practicality of regulatory approaches”. As noted above, we consider it helpful to consider the practicality of different approaches and seeking to identify those that are broadly practical and those that are not.
However, the CAA’s approach is to identify those approaches that are of low, medium and high practicality, with the distinction between medium and high practicality being whether there is an existing precedent in airport regulation. While we consider that precedent of application is useful information, this does not strictly inform whether or to what extent an approach is practical or not. Therefore, we suggest that, in terms of practicality, the CAA identifies only two categories i) impractical (highly unlikely to be technically and/or legally feasible) and ii) practical (likely to be technically and/or legally feasible).

Following this, the CAA could then identify separately from the practical subset, those approaches which have a precedent in airport application and those that do not. It would also be useful for the CAA to indicate whether the precedent is limited to the UK or not and if not to provide examples of where it has been applied and when.

On the classification of those approaches that are practical and those that are not we agree with the CAA on the approaches identified as being low practicality. However, we disagree that “tendering” should be considered practical. Tendering would require a significant change in property rights and as such is unlikely to be legally feasible.

Framework versus RAB supplements

We also consider it useful for the CAA to draw a distinction between those approaches that can be considered regulatory frameworks and those that are supplemental to a RAB-based approach. However, we caution against the CAA taking too broad an interpretation of what constitutes a RAB supplement as some of the approaches categorised as such could in fact be applied independently of a RAB approach, or as a supplement to setting prices under a different (non-RAB based) approach. For example:

- a default contract could be set at a level without reference to a RAB;
- ex post investment prudence could be applied in conjunction with mandatory negotiation; and
- economic depreciation could be applied under a LRAIC approach to setting prices.

The need for new legislation

The CAA indicates against some approaches that it is likely to require new legislation. It would be helpful to draw a distinction between i) new legislation that has already been proposed, for example from the DfT’s decision document in December 2009 and recent statements by the Secretary of State and ii) new legislation out-with that. For example ex post sectoral regulation and reliance on the CAA applying competition law would both be captured by i) whereas tendering would not.

Similarly, “prevention of capacity hoarding” is indicated as requiring new legislation. However, it is not clear that all variants of such an approach would. For example, airports need to notify their capacity to the slot administrator, but in doing this there could be scope for airports to understate their true capacity and as such artificially reduce supply. It appears that obligations to prevent such behaviour could be introduced under the current regulatory regime.
LRAIC
As previously discussed with the CAA in the context of the Europe economics report, we consider that LRAIC based frameworks should not be limited to consideration of a bottom-up, model benchmark company. While this is one approach to setting LRAIC-based prices, this could also be done taking a top-down or hybrid approach where prices are determined by reference to the company’s incurred costs.

Concurrency powers
The CAA includes an approach of relying on the CAA applying competition law and indicates that this requires concurrency powers. While this is accurate, there is also the option of relying on the OFT applying competition law, which would not require concurrency powers. It might be worth adding this, for completeness.

Additional approaches
The CAA also requested suggestions for additional approaches not listed on the slides. Other potential approaches\(^1\), which were included in our slides presented at the same working group, include:

- an obligation on an airport to set charges that are fair, reasonable and non-discriminatory (FRND);
- some form of binding arbitration/dispute resolution process, which could be stand alone, or potentially also in conjunction with price regulation; and
- price monitoring, with a threat of re-regulation, potentially similar to the model that has been used in Australia.

Detailed comments – slide 3
This slide seeks to present the different regulatory approaches in three dimensions:

1. whether the approach has precedent in airport regulation (from slide 2);
2. the degree of competition existing in the market; and
3. the novelty of the approach

We consider that this is potentially a useful way to think about the different approaches. However, the slide on its own does not provide sufficient clarity of exactly what is meant by the different terms. Moreover, due to a lack of time to discuss this in any detail at the working group, we find this slide rather confusing.

Precendent versus novelty
It is not clear what the distinction is between these two dimensions. In one sense, if an approach has no precedent, then it is novel. However, this cannot be what is intended as “negotiated settlement” is identified as having no precedent in airport regulation but as not being that novel. In addition, “ex post regulation” is identified as having precedent and as being highly novel. One

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\(^1\) We note that these could be included as a sub-set of the “ex post sectoral regulation” approach but there is benefit of identifying these separately.
explanation might be that the precedent dimension is broader than the UK, while the novelty dimension is UK specific, but this is not clear. We would welcome further clarity from the CAA on this.

**Degree of competition existing in the market**

A point we made at the working group was that this dimension needs to be broader and include a forward-look of competition as the CAA, when determining what regulation, if any, is appropriate for an individual airport, will need to take a view as to how it expects competition to develop, not only the degree of competition prevailing at the time.

A further point is that the three competition sub-sets could benefit from being refined. Working on the basis that SMP is the grounds by which ex ante regulation can be justified, the category of market power at the left of the x-axis might benefit from being something more akin to “entrenched dominance or entrenched market power” rather than the broader concept of SMP. This would make a distinction between a situation where the CAA concludes that an airport has SMP on a forward-looking basis, but there is some competition or the prospect for some competition to emerge and the situation where an airport faces very little competition and there is very little prospect of any competition emerging.

It is not clear what is meant by “transitional/medium”, but this might be similar to the situation in the previous paragraph, where the CAA concludes that an airport has SMP on a forward-looking basis, but there is some competition or the prospect for some competition to emerge.

“Competitive markets” we assume means the situation where the CAA concludes that an airport is not in a dominant position/ does not have SMP. As such there would be no need or basis to impose ex ante regulation and no grounds to use competition law to address abuse of dominance as the airport would have been found not to be dominant (although another competing airport or airports in the relevant market might be found to be dominant/ have SMP).

**Categorisation of alternative approaches**

A point was made at the working group that some of the boxes in which the alternatives are placed should be much broader, in that they could be implemented in a broader set of competitive conditions than indicated by the chart. We agree with this point.

We agree (and we made this point in our presentation at the working group) that a RAB-based control (with or without enhancements such as capital expenditure triggers and constructive engagement) is most appropriate where there is entrenched market power and as such should very much be to the left of the x-axis on the chart. However, we would argue that some of the other alternatives potentially could be applied across a broader range of competitive conditions. For example:

- The use of a default contract could be applicable in a market where there is competition present (or expected to become present) as well as where it is not;
- There does not appear to be an underlying reason why the use of economic depreciation should be limited to circumstances only where there is entrenched market power;
- A LRAIC-based price cap could be applicable across the whole range of competitive conditions where price regulation is justified; and
• Reliance on competition law or negotiated settlement should not only be limited to where there is near effective competition.

We would suggest that the CAA give further consideration to the ‘breadth’ of the different alternatives on its chart on slide 3.

Potential alternative/complementary classification framework

An alternative way for the CAA to consider the classification of the alternative approaches, which could be complementary to its current proposed approach, is to seek to evaluate and classify the approaches against its statutory duties. While, as discussed at the stakeholder working group, there is uncertainty as to what these might be in the future it seems that the CAA could do this under two circumstances:

1. its current statutory duties as set out in the Airports Act 1986; and
2. its prospective new duties as set out in the DfT’s decision in December 2009, which the new government’s statements seem to support (or at least do not contradict).

For example under 2. the CAA would evaluate each alternative against whether it:

1. promotes effective competition between airports in the interest of current and future passengers;
2. secures efficient investment; and
3. is consistent with the principles of better regulation

Next steps

We hope you find these comments helpful and constructive and we are happy to discuss these in more detail if you would find that useful. We are also happy for you to publish these comments on your website.