Reforming the Framework for the Economic Regulation of Airports
Decision Document

December 2009
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1. Executive summary

Context to reforming the economic regulation of airports

1.1 The Government issued a Consultation in March 2009 on its proposals to update and reform the framework for the economic regulation of the airports sector in Great Britain. Following consideration of responses to its Consultation, the Government announces a package of reforms designed to modernise the airport economic regulatory regime and put the passenger at its heart. This decision document sets out those reforms and their rationale.

1.2 The current regulatory regime for airports was established over 20 years ago in the Airports Act 1986. Since then, there have been a number of developments in the sector, not least the liberalisation of air services and the resulting growth of competition between airports. There have also been developments in our understanding and execution of utility regulation, that has resulted in major changes to the statutory framework for other major regulated sectors in the UK.

1.3 In recognition of this, the Secretary of State for Transport announced a review of the framework of economic regulation of airports, in April 2008. In a written statement to Parliament the Secretary of State outlined the following key policy objectives of the Review:

- Improving the passenger experience;
- Encouraging appropriate and timely investment in additional capacity to help deliver economic growth in line with Government policy; and
- Addressing the wider environmental impacts from airport development.

1.4 The Secretary of State also stated that “if legislation is required as a result of this work, it would be taken forward in a future legislative session. Therefore we will not make changes to the basis on which the current price caps at Heathrow and Gatwick airports are set. This also applies to the cap which will take effect at Stansted from 1 April 2009.”

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1 We are discussing with the Devolved Administrations the applicability of these proposals to Northern Ireland.
2 The provisions of the Airport Charges Directive (ACD) will nevertheless need to be applied to all airports from 2011.
Placing the interests of consumers at the centre of the regulatory framework in those sectors of the economy that have independent economic regulators has been a consistent theme of regulatory reform over the last 10 years in the UK. This approach recognises that in competitive markets meeting the interests of consumers drives the actions of service providers. Economic regulation is intended as a substitute for strong competitive pressures in sectors where companies have substantial market power (and where regulatory intervention is warranted). In these circumstances we believe that the key focus of economic regulators should be to promote and protect consumers’ interests. The Government is therefore seeking to put passengers at the centre of the new regulatory framework for airports through: a new primary duty for the economic regulator – the Civil Aviation Authority (CAA) – to promote the interests of passengers; enhanced passenger representation through the new role for Passenger Focus in the aviation sector; and new rights of appeal for the passenger representative.

The promotion of passengers’ interests will generally be best achieved through the promotion of competition between airports, and this is reflected in the CAA’s new primary duty. However, for the foreseeable future there are likely to remain airports that have substantial market power or dominance and for which it remains appropriate to continue economic regulation. The new licensing regime will allow the CAA to tailor regulation to best meet the particular circumstances of such airports, ranging from price caps to price surveillance. The new sanctions regime, similar to that in other regulated sectors, will also help the CAA to seek to ensure that licence conditions are complied with. As part of the new licensing regime the proposals will give long-term effect to elements of the EU Airport Charges Directive (ACD) through licences for all airports with more than 5 million passengers.

Investment in new and improved facilities is likely to remain a key way in which airports can better meet passengers’ requirements. These decisions should further improve the climate for investment by moving the regulatory regime closer to understood best practice from other sectors. As such the reforms include new provisions to promote financial resilience of major airports.

In light of the environmental objective for the Review, the Government will introduce a supplementary duty on the environment to seek to ensure that economic regulation takes place in a way that is consistent with the variety of legally enforceable environmental obligations airports are subject to. Going further than this and using economic regulation as a means of addressing the environmental externalities associated with airport development risks distorting competition. This is because, in discharging its economic regulation of airport functions, the CAA can only directly influence airport conduct at airports with substantial market power where regulatory intervention is required (currently Heathrow, Gatwick and Stansted). However, the CAA’s other regulatory functions impact on industry

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3 The phrase “where an airport has substantial market power and where regulatory intervention is warranted” is used as short hand throughout this document for an airport which meets the three criteria for a tier 1 licence. For more information on these criteria, see Chapter 4.

4 Throughout this document the word passengers is used as shorthand for end users of airport services.

5 Passenger Focus is officially known as the Rail Passenger’s Council.
in a more uniform way so that such problems do not arise. Therefore, we are consulting separately, on a proposal to apply a general objective to the CAA (which would not apply to the CAA’s airport economic regulation functions) that would require the CAA, where possible and appropriate, to have regard to environmental factors and seek environmental improvements when discharging other regulatory functions. This proposal can be found in ‘Regulating Air Transport: a Consultation on proposals to update the Civil Aviation Regulatory Framework’.

1.9 A key part of the new regulatory regime, alongside the reforms to the CAA’s governance following Sir Joseph Pilling’s strategic review of the CAA, is to recognise that the CAA is the expert economic regulator, and best placed to decide the detailed implementation of policies to further passengers’ interests, subject to appropriate checks and balances. Improved consultation processes, flexibility to introduce terminal competition if appropriate and options for wider service quality measures should all allow the CAA to further the interests of passengers.

1.10 We set out below the key decisions that are discussed in the main document.

Reforms to the economic regulation of airports

Reforming the statutory duties of the economic regulator

1.11 In addition to certain supplementary duties, the single primary duty of the CAA will be to require it:

“to promote the interests of existing and future end consumers of passenger and freight services at airports in Great Britain, wherever appropriate by promoting effective competition”.

1.12 The supplementary duties will require the CAA:

i. “to have regard to the airport operator’s legal obligations to comply with applicable environmental and planning law;”

ii. “to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently;”

iii. “to ensure that licence holders are able to finance the activities which are subject to the relevant licence obligations;”

iv. “to have regard to guidance issued by the Secretary of State, as well as any National Policy Statement on airports;” and

v. “to have regard to the principles of Better Regulation and to consult with stakeholders, including airlines”.

1.13 These duties will replace the four co-equal duties of the CAA. The supplementary duties are intended to provide further clarity to the CAA about the additional factors it should take into account when making its decisions. These duties are subordinate and will not override, individually or collectively, the primary duty. The exact wording of the duties will be subject to further input by Parliamentary Counsel and Parliament.
Introducing a new licence regime

1.14 We will be introducing a new licensing regime that is similar to many other regulated sectors. The main elements of our decisions are to:

- Introduce a two-tier licensing structure. Airports in Tier 1 will be those with substantial market power where regulatory intervention is warranted, while those in Tier 2 will be all other airports meeting the 5 million passenger a year threshold in the Airport Charges Directive (ACD). Currently, apart from provisions necessary to ensure that the licence is effective, such as a revocation condition, the DfT is anticipating that the Tier 2 licences will only include provisions directly related to the ACD.

- Introduce primary legislation based on the current designation/designation criteria to determine whether an airport has a Tier 1 licence. The appeal mechanism for the CAA’s decision about whether an airport should have a Tier 1 licence is discussed in Chapter 6.

- Seek advice under Section 16 of the Civil Aviation Act 1982 from the CAA regarding the drafting of some licence conditions. This advice will be taken into account by the Secretary of State in formulating draft licence conditions to be published for consultation. Following consultation, the Secretary of State would be responsible for deciding upon the precise content of and issuing the initial licences.

- Give the CAA sanctions and enforcement powers for breach of licences similar to the powers held by other economic regulators in the UK. This includes the use of enforcement orders to incentivise compliance with licence conditions. The CAA will be required to develop and publish an enforcement policy.

- Give the CAA powers to impose financial penalties for the breach of licence conditions up to a maximum of 10% of the annual turnover of the regulated business.

- Give the CAA concurrency competition law enforcement powers for services provided by airport operators. We are separately consulting on giving the CAA additional concurrent power, which would cover services provided at the airport by parties other than the airport operator.

- Introduce provisions which enable airports to retain their status as statutory undertakers.

Promoting financial resilience

1.15 The Government will be introducing a financial resilience package that consists of:

- A supplementary financing duty for the CAA that is similar to the financing duty many other UK economic regulators have.

- A minimum credit worthiness requirement for Tier 1 airports.

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6 Regulating Air Transport: Consultation on proposals to update the regulatory framework for aviation. December 2009
http://www.dft.gov.uk/consultations/open/regulatingairtransport
1. Executive summary

- Ring fencing provisions similar to those in place in the energy, water and rail sectors for Tier 1 airports. There will be initial derogations for some of these ring fencing provisions because the costs of introducing those provisions currently exceed their benefits.
- We have decided that the benefits of Special Administration are not sufficient to support its introduction.

1.16 The Government will also be consulting on:
- A mechanism to switch on those ring fencing provisions granted derogations upon the introduction of the licence in order to move to a full ring fence over time. The granting and removal of future derogations would be a licence modification matter and is outside the scope of the consultation published alongside this document.
- A licence condition that would require Tier 1 airports to put in place a Continuity of Service Plan in the case of insolvency.

Enhancing Accountability

1.17 We recognise the importance of having strong checks and balances on the CAA to ensure high quality decision making, so we have decided that:
- The Competition Appeal Tribunal (CAT) should be the body that considers appeals regarding Tier 1 licence decisions, and the appeal should be an adjudicative appeal. The licence holder or potential licence holders and all other parties with a material interest (which will be determined by the CAT) should have a right to appeal. The Secretary of State will also have the right to refer a Tier 1 decision to the CAT.
- Licence modification determinations by the CAA will be subject to a right of appeal to the Competition Commission by way of an investigative procedure. Licence holders, as well as the Secretary of State and Passenger Focus as the passenger representative body for passengers’ interests will have the right to challenge CAA proposed licence modifications and determinations.
- Licence conditions giving effect to the Airport Charges Directive (ACD) may only be modified by the Secretary of State.
- The CAA will be required like most other economic regulators to include relevant information in its annual report, annual accounts, and its forward-looking corporate plan.

Enhancing passenger representation

1.18 We have decided that Passenger Focus is the most appropriate body to represent air passengers in relation to airport and airline issues and that air passenger representation should be funded via the airport licence fee. This will ensure that passengers have an independent, authoritative and influential passenger advocate whose integrated perspective will be more aligned with the passengers’ perspective. We recognise that stakeholders have raised a number of practical issues around implementation, in particular how Passenger Focus will interact and work with other bodies, and we will ensure that these are addressed in implementing this decision.
Aligning airport services with passengers’ needs

1.19 To ensure that the CAA has the powers and flexibility to regulate to best meet the interest of passengers, we have decided that:

- To help ensure that Tier 1 airports’ expenditure programmes are better linked to passengers’ needs, the CAA should build on the process of Constructive Engagement through enhanced information and consultation provisions in licence conditions. These conditions will build on the requirements of the ACD (the provisions of which will also be applicable to Tier 2 airports).

- The CAA should be encouraged to consider whether wider service quality measures would be appropriate to improve the overall passenger experience.

- Inter-terminal competition should not be precluded under the new regulatory regime, if and where the CAA considers that it will bring benefits to passengers.

Endorsing governance changes

1.20 When considering reforms to the statutory remit of economic regulation of airports we recognise that the specific wording in statute can only go so far in determining outcomes and ensuring a fit for purpose regulatory regime. The governance arrangements for the CAA will also play a major role in the effective operation of the regime and ensure that the CAA is as well placed as possible to exercise its new powers. In line with the recommendations from Sir Joseph Pilling’s strategic review of the CAA, its governance structure has been updated. The Board is now headed by a non-executive Chair and has full responsibility for all of the CAA’s decisions and the organisation is now led by a full time Chief Executive. This is consistent with the structure of other UK economic regulators and should help to ensure we have a high quality regulatory regime.

Next steps

1.21 Whilst the decision represents Government policy, much of it requires primary legislation to take effect. The decisions are therefore, in effect, the Government’s proposals on economic regulation of airports that will be placed before Parliament. The Government will seek Parliamentary time to introduce a Bill, at the earliest opportunity. Consequently, throughout this document, although the measures discussed are the decision of the Secretary of State for Transport (the “Secretary of State”), they also constitute a proposal for legislation that the Secretary of State will place before Parliament.

1.22 Similarly, whilst we have taken care to draft, for example, our decision on the primary and supplementary duties to reflect our policy intent, their precise wording will need to be reflected in appropriate legal wording and debated as part of the Parliamentary process. Consequently, readers are advised to focus on the policy intent of the decisions in this document, rather than their precise wording.
1.23 The Government intends this proposed legislation will be the basis for giving permanent effect to the requirements of the ACD. This Directive is required to form part of domestic law by March 2011, which is highly likely to be before full effect can be given to the licensing regime envisaged by this document. The Government therefore intends to implement the Directive firstly by Regulations made under the European Communities Act 1972 and subject to consultation in summer 2010. The existence of these Regulations will not preclude Parliamentary consideration of the areas which are common to both the Directive and the proposals in this document. Equally, in publishing and consulting on the details of Regulations we will be mindful of the legislative process. We intend that, where relevant, the policy in this document will be reflected in a draft set of Regulations published for consultation in summer next year.
2. Undertaking the Review

Introduction

2.1 In this Chapter we set out the broad rationale for the decisions, the evidence that was considered, and the structure of the following chapters. It is important to note that whilst what follows represents Government policy, much of it requires primary legislation to take effect. They are therefore, effectively the Government’s decisions on the economic regulation of airports that will be placed before Parliament. The Government will seek Parliamentary time to introduce a Bill which reflects these decisions, at the earliest opportunity. Consequently, throughout this document, although the measures discussed are the decision of the Secretary of State for Transport (the Secretary of State), they will also inform the content of the proposed legislation that the Secretary of State will place before Parliament.

2.2 The framework for airport economic regulation in Northern Ireland closely follows that for other parts of the UK and is overseen by the CAA. However, it is governed by separate legislation. In so far as the proposed legislation includes or touches upon transferred matters we are in discussion with the Northern Irish Administration and where they do not we would, in principle, expect them to apply to the UK. Accordingly, references to Great Britain and the UK throughout this decision document should be read in light of this.

2.3 It is a truism that markets, where they work effectively, ensure the best outcome for society, and in particular for the consumers within the market. However, where markets do not work effectively, and particularly where there is persistent and substantial market power, there can be an important role for regulation. The role of economic regulators in this situation is to ensure, as far as possible, an outcome that broadly approximates that of a competitive market, and by doing so, protect consumers from abuse of substantial market power.

2.4 In order to intervene effectively regulators need:

- A clear mandate (i.e. all should be clear on why the regulator decides to intervene and its objectives);
- a flexible set of regulatory tools (to ensure that interventions are appropriate, proportionate and best calculated to meet the regulatory need); and
2. Undertaking the Review

- to be properly accountable for their actions, by providing an adequate appeals process.

2.5 That is why the proposals that follow in the forthcoming chapters explain our decisions to:

- Place the passenger at the heart of the regime, by making this group the focus of a single primary duty for the CAA, and the establishment in Passenger Focus of an independent statutory advocacy body for air passengers;

- introduce a licence based regime to allow the CAA to respond flexibly and proportionately to market situations and the presence of substantial market power; and

- introduce an appeals process which effectively balances the rights of stakeholders to appeal decisions which affect them against the costs of such appeals.

2.6 Throughout this review, and throughout this decision document, when we refer to the interests of passengers we are considering their interests in a broad sense. In particular, we recognise that passengers are interested in the overall price and service quality combination that best meets their needs, and that the quality of service has many different components. The importance of the quality of service for passengers emphasises that investment, whether in terminal facilities or surface access facilities to an airport is likely to be a key issue for the regulatory regime to consider to help ensure passengers can obtain the price and service quality combinations they want.

Evidence considered during the review

Consultations

2.7 The Review has considered both the need for intervention, and the possible shape of any intervention from first principles. In doing this, it has been informed by its own work, advice from an Expert Panel, and the responses from three separate evidence gathering exercises including the stakeholder consultation dated March 2009.7 To ensure that our proposals were well founded in theory, fact and stakeholder experience, the Secretary of State sought the views of stakeholders on his initial proposals for a new regulatory regime in March 2009. The 79 responses to this consultation, have, in common with the two previous consultations, been considered carefully. A summary of the consultation responses is published alongside this decision document8. Short summaries are also provided in the decision document itself. In both cases, it should be noted that these are summaries, rather

7 Call for evidence on the review of the regulatory framework for airports (June 2008) http://www.dft.gov.uk/pgs/aviation/airports/reviewregulationukairports/callforevidence/
Reforming the framework for the economic regulation of UK airports:A Consultation (March 2009) www.dft.uk/pgs/aviation/airports/reviewregulation/airports/

8 www.dft.gov.uk/consultations/closed/ukairports/
than a verbatim collection of the responses received. It should also be noted that not all stakeholders commented on every question included in the consultation document.

The Expert Panel

2.8 The Review has also been advised by a panel of independent experts who have led their own work programme alongside the DfT, with the support of the Review team where requested. The Panel was chaired by Professor Martin Cave of the University of Warwick Business School. The work programme of the Panel has included seminars with interested stakeholders, with details published on the DfT website. It has also met bilaterally with a range of interested parties. The DfT published the Panel’s advice to the SoS alongside the March 2009 consultation and its final views on an appropriate economic regulatory regime for UK airports is published alongside this decision document.

The Competition Commission’s Market Investigation

2.9 The Competition Commission’s market inquiry into BAA also provided further and important evidence to the Review. We have considered the recommendations of the Competition Commission as part of the evidence set which has underpinned the Secretary of State’s decision. In reaching his decision, the Secretary of State has taken care to consider fully all of the consultation responses received. We note that the Competition Commission focuses exclusively on identifying features of the market that prevent, distort or restrict competition, whereas Government policy must also balance this against wider issues. We believe that our analysis of all of the evidence received has led the Secretary of State to make a decision that, whilst different to the Competition Commission’s recommendations in some respects, is broadly consistent with their recommendations.

Structure of the decision document

2.10 The remainder of this decision document is structured as follows:

- Chapter 3 outlines our proposals on the statutory remit of the CAA as an economic regulator, and the structure of its duties.

- Chapter 4 outlines our proposals for a flexible, fair and effective enforcement regime, including our proposals on licence structure, conditions, modification, and the sanctions and enforcement regime.

- Chapter 5 details our proposals on the package of measures designed to encourage appropriate, timely and efficient investment, and protect the passenger. The Government had already announced this package at a high level in October 2009.

- Chapter 6 outlines our proposals for enhancing the accountability of the CAA as an economic regulator through an appeals regime.
2. Undertaking the Review

- Chapter 7 sets out our proposals for enhanced passenger representation within the new framework including our decision on the role of a new independent body to represent the interests of air passengers.
- Chapter 8 sets out our proposals on a range of important regulatory features such as evidence gathering powers, and the service quality regime.
- Annex 1 lists the set of questions that stakeholders to the March 2009 consultation were asked.
- Annex 2 contains a list of respondents to the March 2009 consultation.
- Annex 3 explains the current provisions that apply to airports deemed as Statutory Undertakers.
3. Statutory remit for the economic regulation of airports

Introduction

3.1 The statutory remit of a regulator sets its aims and objectives. A clear remit will enable the regulator to readily understand its principal purpose and focus its activities accordingly. It will also help regulated companies, customers, investors and other stakeholders to better understand the decisions of the regulator. It is worth noting that the duties discussed in this chapter apply to the exercise of the CAA’s airport economic regulation functions. These economic functions do not provide the CAA with any power or obligation to directly influence airport conduct, other than for those airports with substantial market power and where regulatory intervention is warranted.⁹

3.2 In this chapter we:
   - set out the current statutory remit of the CAA;
   - summarise proposals to reform the CAA’s statutory remit, which were consulted upon earlier this year (the financing duty is considered in Chapter 5);
   - set out the proposed reforms that were subject to consultation;
   - summarise the consultation responses received; and
   - explain our decisions on how to reform the statutory remit of the CAA.

3.3 This chapter sets out our policy intentions for reforming the economic regulator’s statutory remit. In order to further clarify our policy intent we have also provided an indication about the way in which the specific duties might be worded, but we note that the precise wording of these duties will be subject to further input by both Parliamentary Counsel and Parliament.

⁹ The conduct of airports with more than 5 million passengers per year will be affected by the UK implementing the provisions of the Airports Charges Directive (ACD), via the airport licence. However, it is intended that the tier 2 licence will not enable the CAA to affect an airport’s conduct other than by implementing the provisions of the ACD.
3. Statutory remit for the economic regulation of airports

Current statutory remit of the CAA

3.4 Under current arrangements, the CAA has a discrete set of duties for the purposes of economic regulation which were set out in statute by the Airports Act 1986. These duties state that the CAA must perform its functions in respect of economic regulation in a manner which it considers is best calculated to:

- Further the reasonable interests of users of airports within the UK;
- promote the efficient, economic and profitable operation of such airports;
- encourage investment in new facilities at airports in time to satisfy anticipated demands by users of such airports; and
- impose the minimum restrictions that are consistent with performance by the CAA of its functions.

3.5 We expect the new regulatory framework will include a power for the Secretary of State to require the CAA to pay due regard to such international obligations as may, from time to time, be notified by him to it.10

3.6 The CAA also has a set of general statutory duties which were set down in statute by section 4 of the Civil Aviation Act 1982 and are expressly disapplied to airport economic regulation. The DfT has been reviewing these duties following the recommendations of the Pilling report and is currently consulting separately on proposals for giving the CAA new general objectives to enable the CAA to carry out its regulatory activities in a manner that is fully consistent with protecting the public interest in aviation.

3.7 The DfT is proposing three new general objectives which would require the CAA to pursue the reasonable interests of consumers; secure a high standard of safety; and have regard to environmental factors and seek environmental improvements where possible and appropriate. These general objectives will not apply to the CAA’s airport economic regulation function due primarily to the competitive distortions that could arise as a result of using this function as a means of achieving environmental objectives. In relation to the other general objectives, the framework for economic regulation of airports will already have a clear primary duty focused on the end user of airport services, and the regulation of safety for airports is carried out separately from economic regulation). The general objectives are set out in more detail in a separate consultation published alongside this decision document.

3.8 The new framework for the economic regulation of airports only enables the CAA to directly influence airports with substantial market power and where regulatory intervention is warranted (currently Heathrow, Gatwick and Stansted). In contrast, environmental externalities will be present at a much broader range of airports. As a result we believe that applying the proposed general objectives to the CAA’s airport economic regulation function could potentially distort competition and would not cover most airports. We are therefore proposing that the general objectives will not apply to the CAA’s

10 More information on key international obligations is available in Annex 4 of the consultation document.
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airport economic regulation functions.\textsuperscript{11} It is also worth noting that we intend to restrict the ability of the regulator to introduce conditions into an airport’s economic licence which are not related to economic regulation.\textsuperscript{12} We believe this is necessary to maintain a clear focus on economic regulation and it is consistent with the principles of Better Regulation.

Consultation proposals to reform the CAA’s statutory remit

3.9 The Consultation document proposed to replace the four duties of the CAA with a single primary duty of the following general kind for the purposes of airport economic regulation:

“to promote the interests of existing and future consumers of passenger and freight services at UK airports, wherever appropriate by promoting effective competition”.

3.10 In addition, the Consultation proposed five supplementary duties:

i. To have regard to the effect on the environment and on local communities of activities connected with the provision of airport services;

ii. to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently;

iii. to ensure that licence holders are able to finance the activities which are subject to the relevant licence obligations;

iv. to take account of guidance issued by the Secretary of State, and to assist in delivery of airport infrastructure consistent with the National Policy Statement on Airports unless there are compelling reasons not to do so; and

v. to have regard to the principles of Better Regulation and any other principles appearing to represent the best regulatory practice, and to consult with stakeholders, including airlines.

3.11 The Consultation document sought views on both the policy intent and the proposed general wording of the duties (noting that the precise drafting of any duties to be included in legislation to implement the proposed reforms will be subject to further legal input from Parliamentary Counsel and Parliament). The consultation asked stakeholders (question 6.8) for their views on the appropriateness of the proposed duties and in particular, whether they will allow for an effective and efficient regulatory regime that meets the Secretary of State’s objectives for the Review. In considering the proposed duties stakeholders were asked for their views on the following specific questions:

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\textsuperscript{11} One might argue that an alternative means of achieving an environmental objective is via the imposition of licence conditions; however similar distortions could arise as only airports with greater than 5 million passengers (currently 13 airports in the UK) will require an economic licence to operate.

\textsuperscript{12} However, it is intended that the Secretary of State would have a power to add other matters in respect of which licence conditions may be made.
3. Statistical remit for the economic regulation of airports

- Whether the proposed duties provide a sufficiently clear framework for the CAA to operate within?
- Whether the proposed hierarchy and number of duties for the CAA are appropriate?
- Whether there are other factors or issues that should be included in additional specific duties?
- Whether the initial draft wording for the duties is appropriate.

Structure of the economic regulator’s duties

Government’s proposal

3.12 The Consultation document proposed to replace the four co-equal duties of the CAA with a single primary duty to promote the interests of consumers of passenger and freight services at UK airports, wherever appropriate by promoting effective competition, which would be supported by a number of supplementary duties.

3.13 The Consultation document noted that some stakeholders were unclear about how the CAA balances its current duties and others were concerned it placed undue prominence on specific duties (for example the Competition Commission raised concerns that the CAA may place undue prominence on its duty to impose minimum restrictions). The structure proposed was therefore intended to provide a clear hierarchy based on focusing on passengers interests, to enable the CAA to make clearer decisions, with stakeholders better able to understand why those decisions have been made.

3.14 The Consultation document also made it clear that the supplementary duties are factors that the CAA should also consider when seeking to achieve its primary duty; but they should not override, individually or collectively, the CAA’s primary duty to passengers. In relation to the proposed structure of the duties, the consultation document asked the following questions (question 6.1):

- Does the proposed hierarchy of the duties – with a single primary duty supplemented by a set of further duties that the regulator should also consider when seeking to achieve its primary duty – provide sufficient certainty over the regulator’s priorities?
- Are there alternative arrangements which would provide additional regulatory clarity?

Consultation responses

3.15 In general, the responses received by the DfT were supportive of the proposal to have a primary duty focussed on promoting the interests of passengers, supported by a number of supplementary duties. However, this was not universally the case. For example, Belfast and Cardiff International Airports felt that the hierarchy of duties offered no additional benefit over and above the current regime. Both felt the primary duty was too simple...
and that the supplementary duties were potentially conflicting. In addition, some stakeholders suggested that other factors (e.g. the environment) should be placed on an equal footing with passengers’ interests.

**Government's decision**

3.16 It is important to note that the supplementary duties are supplementary – they are subordinate and accordingly do not override, individually or collectively, the regulator’s primary duty; however, in practice the subordinate duties may often reflect or reinforce the facets of the principal duty. The DfT acknowledges that the CAA will have to take into account a number of factors but any regulator will need to take account of potentially competing factors (and consistent with good regulatory practice, explain how this trade-off has been exercised). We believe the simplicity of the primary duty, combined with the proposed structure, will provide as much clarity as possible to both the regulator in taking decisions as well as wider stakeholders in terms of why those decisions have been made. The majority of stakeholders agree that this approach would provide additional clarity over and above the current set of co-equal duties. For these reasons and to ensure consistency with the principles of Better Regulation to maintain the focus of economic regulation on addressing substantial market power, we have decided to retain the structure proposed in the consultation document.

**Primary duty**

**Government's proposal**

3.17 The consultation document proposed to replace the four co-equal duties of the CAA with a single primary duty of the following general kind:

> “to promote the interests of existing and future consumers of passenger and freight services at UK airports, wherever appropriate by promoting effective competition”.

3.18 The consultation document made it clear that the principal objective of economic regulation in the airports sector is to promote the interests of end users of airport services. In practice, end users of airport services will mostly comprise passengers and for simplicity we refer to ‘passengers’ as short hand for end users of airport services throughout this document.

3.19 Even though they are not the ultimate focus of the regulatory regime (and are therefore not included in the primary duty), the consultation document noted that airlines will also be an important source of information on passengers’ interests, including in relation to areas of airport activity which passengers do not directly observe but which have a direct impact on their through airport experience. Therefore it is important that there are other provisions within the proposed reforms that ensure airlines’ views, where appropriate, are taken into account.
3.20 The consultation document asked stakeholders the following questions (question 6.2):

- Do you agree with the proposed primary duty? Do you have any comments on the drafting of the primary duty?
- Do you agree with the proposed approach of putting the passenger experience at the centre of the regulatory regime with additional rights for airlines and enhanced consumer representation?
- Is promoting effective competition the best way to promote the interests of consumers of airport services?

Consultation responses

3.21 There was widespread support for a primary duty focussing on the interests of passengers from airport operators, consumer representative groups and the CAA.

3.22 However, the airlines and their representatives expressed some concerns. One concern expressed by this group was that the duty as proposed may require the CAA to intervene in all activities at an airport, including those being delivered by airlines and other third parties, rather than focusing on the services delivered by airports. Concern was also raised that the wording of the primary duty carried the risk that the CAA would make its own judgement about what passengers wanted, without taking the views of airlines into account.

Government's decision

3.23 The ultimate aim of economic regulation is to, as far as possible, replicate the outcome of a competitive, well-functioning market which serves the interests of passengers and the primary duty is intended to reflect this. In response to concerns that the general wording proposed may require the CAA to intervene in activities delivered by airlines and other third parties we note that the new licence based regime (discussed in more detail in the following chapter) will only enable the CAA to directly regulate the airport operator as it is the airport operator who will require a licence to operate and to which conditions can be attached. The CAA will therefore have no means of directly regulating third parties, including airlines, under its airport economic regulation functions. That said, if the CAA concluded that if an airport was subject to effective competition it would be better incentivised to: i) ensure coordination between the services it provides directly and those which it subcontracts/rents out to third parties; and/or ii) influence the quality of services provided by third parties trading at the airport (and with which the airport operator would have contracted), then we would expect the CAA to take appropriate action, perhaps initially by putting in place incentives for the airport operator to deliver outcomes which more closely mirror those of a competitive, well-functioning market. This would be in line with its primary duty to promote the interests of passengers.

13 The CAA does have powers to regulate airlines as part of its wider functions (e.g. in relation to safety).
3.24 The consultation document acknowledged the previously expressed views of the airlines (that the primary duty should refer to users – both consumers and airlines). These views were reiterated by airlines in their responses to the consultation. Given the broadly competitive nature of the airline market, the incentives of passengers and airlines will frequently be aligned, but this is not universally the case. Where their incentives are not aligned, the interests of end users of airport services should quite properly take precedence over airlines’. However, recognising that their views will frequently be aligned, there are a number of reforms which will provide airlines with additional rights within the regulatory process and should therefore facilitate their views, where appropriate, being taken into account. These include:

- Supplementing the regulator’s primary duty with a duty to consult stakeholders, including airlines;
- introducing licence conditions obliging the airport operator to provide information to and, to consult with airlines;\(^{14}\) and
- providing airlines with rights to appeal the regulator’s decisions about which airports should be subject to a Tier 1 licence (see chapter 6 for further details).

3.25 It is notable that few of the responses discussed, to any significant degree, the second part of the proposed primary duty regarding the promotion of effective competition. The Government regards this as an important part of the primary duty that reflects the expectation that well functioning competitive markets can and do, in many cases lead to favourable outcomes for passengers. This part of the primary duty should also act to re-assure stakeholders that the scope of the CAA’s regulation of airports will focus on those airports where competitive pressures are not sufficient to protect passengers’ interests.

3.26 To summarise, consultation responses have not led us to revise the policy intention for proposing this duty; that the CAA should have a primary duty to promote the interests of end consumers of passenger and freight services – both existing and future. We believe that a primary duty focussing on passengers is crucial to putting the passenger at the heart of the new regulatory regime. However, we believe it is important to clarify exactly who is captured by the primary duty and we believe our policy intent is more accurately captured by a duty requiring the CAA:

“to promote the interests of existing and future end consumers of passenger and freight services at airports in Great Britain, wherever appropriate by promoting effective competition”.

\(^{14}\) For Tier 2 licences, these obligations will be limited to the implementation of the ACD provisions.
Supplementary duty on the environment

Government's proposal

3.27 There are a number of externalities associated with the development of airport infrastructure, including positive externalities associated with economic growth and productivity, as well as negative externalities associated with adverse impacts on the environment. The Government’s view is that it, and not an independent economic regulator, should determine policy in relation to the treatment of such externalities through the planning process, and that the appropriate planning authority should then have regard to this policy when considering the impact of specific investment proposals that may be brought forward. It is consistent with the principles of Better Regulation to maintain the focus of economic regulation on addressing substantial market power.

3.28 However, in order to ensure that economic regulation takes place in a way that is consistent with an airport’s environmental obligations (resulting from both environmental and planning law) the consultation document proposed a supplementary duty of the following general kind:

“To have regard to the effect on the environment and on local communities of activities connected with the provision of airport services”

3.29 The consultation document stated that this supplementary duty should not override the regulator’s primary duty to focus on the interests of consumers; nor was it intended to encourage the CAA to duplicate existing environmental provisions. Stakeholders were asked the following questions (question 6.3):

- Do you agree that it is appropriate for the economic regulator of airports to have regard to the effect on the environment and on local communities of activities connected with the provision of air services?
- Does the proposed duty provide sufficient clarity over the respective roles of the Government and the CAA?
- Does the proposed duty risk compromising the clarity of the regulator’s primary duty?

Consultation responses

3.30 Consultation views on this supplementary duty were mixed. Some stakeholders supported the proposed duty and others felt it did not go far enough. For example, The Strategic Aviation Special Interest Group thought that it should be strengthened by requiring the CAA to minimise and mitigate environmental impacts, rather than simply having regard to them. The Campaign to Protect Rural England felt that the wider environmental impact of aviation should have at least equal priority to the interest of passengers.
3.31 Other responses thought that the proposed duty was useful but noted that there were already a range of existing measures that apply to airports on this issue and that these should be taken into account. Some stakeholders (including The Northern Way, London Luton Airport, EasyJet and BAA) noted that the duty should not seek to duplicate what is best dealt with by the planning system.

3.32 In its response, the CAA considered that environmental externalities were likely to be best addressed through broad-based market, fiscal or administrative mechanisms that are not confined to airports with substantial market power, or to the UK airports sector. Other stakeholders (including the Air Transport Users Council and Manchester Airports Group) agreed with the CAA that environmental protection needs to be addressed by all sectors of society. Manchester Airports Group (MAG) felt that giving the CAA an environmental duty would make airports a ‘special case’ by imposing obligations that are not imposed on other industries.

3.33 Other responses gave a range of reasons for not supporting the duty. British Airways (BA) saw the wording as being too broad and thought it implied that the CAA could develop environmental policies of its own. Birmingham City Council and Birmingham International Airport raised the issue of a potential conflict with the role of the Environment Agency (EA). Further concerns were also raised in relation to the funding of the environmental duty and the potential additional regulatory burdens resulting from an extension of the CAA’s remit.

**Government’s decision**

3.34 Most of the issues raised by stakeholders relate to the way in which the duty, as proposed, could be interpreted. Far fewer responses (with the exception of those who thought the duty was either not necessary or did not go far enough) appear to be concerned about the proposed policy intent, which is to ensure that economic regulation works consistently within the framework of existing environmental obligations that impact on the development of airports.

3.35 It is important to clarify that the policy intention for this duty has never been to enable the CAA to use economic regulation as a means of imposing environmental obligations on airports. Whilst we wholeheartedly agree that it is important to address both the positive and negative externalities associated with the development of airports, economic regulation is not the appropriate vehicle to do so because it only enables the CAA to directly affect airport conduct at airports with substantial market power and where regulatory intervention is warranted (currently 3 airports). In contrast, environmental externalities will be present at a much broader range of airports where regulatory intervention is warranted. In addition, it is possible that the number of airports with substantial market power where regulatory intervention is warranted could fall over time. For example, in its BAA airports market investigation, the Competition Commission considered that regulation at Gatwick and Stansted might be withdrawn as greater competition develops under separate ownership. This would make the

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pursuit of environmental objectives via the CAA's airport economic regulation functions even less effective.

3.36 Notwithstanding the fact that economic regulation is not an effective way to address environmental externalities associated with the development and operation of airports, using economic regulation in this way could also distort competition. This would be the case if additional environmental obligations were imposed on airports subject to economic regulation who compete with airports not subject to economic regulation.

3.37 We believe that airport economic regulation is not the appropriate vehicle for addressing the environmental externalities associated with the development of airport infrastructure. However, we are consulting, as part of our other proposals to update the civil aviation regulatory framework,\(^\text{16}\) to give the CAA a general environment objective which would require it where possible and appropriate, to have regard to environmental factors and seek environmental improvements when discharging its other regulatory functions. Unlike the economic regulation of airports, the CAA's other regulatory functions impact on industry in a more uniform way so the potential problems associated with competitive distortions discussed above do not arise.

3.38 As a result of stakeholder responses we have given further consideration to the proposed general wording of the duty to assess whether it could enable the CAA to impose additional environmental obligations on airports with substantial market power where regulatory intervention is warranted and therefore risks creating distortions. Broadly speaking, a ‘have regard to’ duty means that any decision taken by the regulator (in relation to its economic regulation of airports functions) has to take into account the effect on the environment and how it has been considered in the decision taking process. Therefore, it does seem possible that the scope of the duty as originally proposed is capable of extending beyond the policy intent.

3.39 To conclude, our original policy intentions for proposing a supplementary duty on the environment have not changed; we still believe that economic regulation should work consistently within the framework of environmental obligations an airport is subject to as a result of environmental legislation and planning law. To be more specific, we believe the CAA should satisfy itself that an airport operator is giving appropriate consideration to its environmental obligations and the requirements of the planning process before it agrees to incorporate a proposed investment into a price control. However, as a result of stakeholder responses and further consideration of evidence, we agree there is a risk that the general wording proposed in the consultation document could be interpreted more widely than intended. In order to avoid the possible risk of distortions arising as a result of airports subject to economic regulation being subject to additional environmental obligations, we have decided that the CAA should be required:

“to have regard to the airport operator’s legal obligations to comply with applicable environmental and planning law”

\(^{16}\) Regulating Air Transport: Consultation on proposals to update the regulatory framework for aviation” December 2009 http://www.dft.gov.uk/consultations/open/regulatingairtransport
3.40 We do not believe that in complying with this duty, the CAA should seek to pre-empt the conclusions of the planning authorities or duplicate the role of the relevant enforcement bodies. The CAA is funded by industry and as the airline market is broadly competitive, the costs of the CAA duplicating the roles of the planning authorities or the Environment Agency, for example, would be passed on to passengers. This would clearly be unacceptable.

3.41 It is the role of the airport operator to make sure the proposed investment does not violate environmental obligations it is subject to and has a good chance of getting planning permission. However, we believe the CAA should be satisfied that the airport operator is giving appropriate consideration to its environmental obligations and the planning process before it agrees to incorporate a proposed investment into a price control. In satisfying itself of this, the CAA should not duplicate the role of the planning authorities or the Environment Agency.

3.42 We believe this supplementary duty sends a clear message to industry about the importance of ensuring that economic regulation is consistent with an airport’s environmental obligations (resulting from both environmental and planning law), in a way that we believe imposes minimal additional burdens on either the CAA or the airport operator.

**Supplementary duty on reasonable demand and efficiency**

**Government’s proposal**

3.43 Where airports are competing effectively for airlines and passengers, airport operators have an incentive to provide airport services demanded by their passengers – in terms of quality and capacity – at least cost. Where airports have substantial market power this incentive is dampened. To help ensure that, the CAA seeks to replicate the outcome of a competitive well-functioning market where airports provide those services demanded by passengers at least cost, the consultation document proposed a supplementary duty of the following general kind:

“to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently”.

3.44 The consultation document noted that we would expect these regulated service outcomes, in terms of price, quality and quantity, to be based on a consideration of consumers’ willingness to pay for different price/quality combinations. The additional rights of airlines in the regulatory process and improvements to passenger representation within the sector will assist the regulator in setting the appropriate service outcomes that best improve the through-airport experience.

3.45 The following question was put to stakeholders (question 6.4):

- Given the proposed primary duty to promote the interests of consumers, is it necessary to have a further duty to ensure that all reasonable demands are met efficiently?
Consultation responses

3.46 In general the airlines and their representatives were very supportive of this proposed duty and a number of airlines pointed out that a duty to encourage efficiency was vital. Some airports were supportive of the duty on the assumption that it was only relevant to airports where market incentives are dampened (i.e. the Tier 1 airports). BAA said that the definition and interpretation of reasonable demand varies significantly between regulated sectors, and there is no clear model for the CAA to adopt for use in regulating airports. BAA thought that to be effective and workable, any definition of reasonable demand for airports would need to reflect the economic characteristics of the airport sector. Both BAA and the CAA recommended clarifying the definition of reasonable demand.

3.47 The CAA, Air Transport Users Council and Which? questioned what value the proposed duty added over and above the proposed primary duty. Birmingham International Airport and the Birmingham International Airport Consultative Committee were not supportive of the duty. They felt that meeting reasonable demands was a matter for the airport management given the prevailing business climate at the time. The Campaign to Protect Rural England (CPRE) did not support the duty and felt that high quality of service and protecting the environment was more important than meeting demands. The Strategic Aviation Special Interest Group (SASIG) believed that reasonable demands should be framed to include social, economic and environmental aspects.

Government's decision

3.48 We agree that the concepts of efficiency and reasonable demands are implicit in the primary duty. However, the concepts are crucial to achieving the overarching aim of economic regulation – to replicate, as far as possible, the outcome of a competitive, well functioning market – so in our view they warrant explicit consideration. As mentioned in the consultation document, effective competition provides airport operators with incentives to provide airport services demanded by their passengers – in terms of quality and capacity – at least cost outcomes. As a result this duty will only be of practical relevance to airports with Tier 1 licences. In any case, the duties more generally only apply to the exercise of the CAA's airport economic regulation functions, within which the CAA does not have any function or obligation which enables it to directly influence airport conduct, other than those with Tier 1 licences.

3.49 Both the CAA and BAA recommended clarifying what is meant by reasonable demands. We firmly believe it is more appropriate for the expert sectoral regulator to determine exactly what constitutes reasonable demand in a specific set of circumstances.

3.50 Seeing as the ultimate aim of economic regulation is to replicate, as far as possible, the outcome of a competitive market which delivers outcomes in line with what passengers want, we are inclined to agree that the CAA's interpretation – “demands for airport services that are backed by consumers’ willingness to pay in a well functioning competitive airport market” – sounds like a good starting point for assessing whether
reasonable demand exists for additional airport capacity. However, the ultimate determination of what constitutes reasonable demand in a specific set of circumstances and how all reasonable demands for airport services are to be secured will be for the CAA to determine. That said, we do believe it is important to clarify that this duty is not intended to enable the development of airport capacity that would not be undertaken by the airport operator if it were subject to more effective competitive constraints. We consider that this approach is similar to that adopted in other regulated sectors with regard to the expansion of capacity.

3.51 Finally, we do not believe that reasonable demands should be framed to include social and environmental aspects. As discussed above, airport economic regulation is not an appropriate vehicle for addressing environmental externalities because the CAA’s ability to directly influence airport conduct is limited to those airports with Tier 1 licences even though environmental externalities will be present at a much broader range of airports. As discussed in more detail above, using economic regulation as a tool to address environmental externalities would not be effective and could create distortions.

3.52 Therefore, the Government continues to support the position set out in the consultation and believes that the CAA should be required:

“to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently”.

Supplementary duty on guidance

Government’s proposal

3.53 The consultation document proposed a supplementary duty of the following general kind:

“to take account of guidance issued by the Secretary of State, and to assist in delivery of airport infrastructure consistent with the National Policy Statement on Airports unless there are compelling reasons not to do so”

3.54 The consultation document noted that the development of airports can have impacts (e.g. social and environmental) that are not necessarily reflected in airport operators’ commercial cost-benefit analysis. These impacts are best taken into account at the planning stage by the appropriate planning authority. In the case of nationally significant infrastructure projects, impacts will be articulated via a National Policy Statement (NPS) on airports, which will guide the decision making of the independent Infrastructure Planning Commission (IPC). We therefore proposed that the regulator should have a duty to assist in the delivery of airport infrastructure consistent with the Airports NPS, unless there are compelling reasons not to do so. We considered this duty important to provide a clear steer on the relationship between Government policy on the delivery of airport infrastructure and the economic regulator’s decisions with regard to price regulated airports.
3.55 The consultation document proposed that where an airport operator brings forward development identified in the NPS, the economic regulator, subject to its primary duty, would be expected to set the price cap at a level to accommodate the delivery of the proposed project. Where delivery of the proposed project was not consistent with its primary duty, this would represent a compelling reason not to accommodate the project in the price control.

3.56 The following questions were put to stakeholders (questions 6.7 and 6.8):

- Does the proposed duty provide the right balance between the roles of the Government and the CAA?
- Does the proposed duty risk compromising the clarity of the regulator’s primary duty?

Consultation responses

3.57 A number of airlines and their representatives felt this duty risked undermining the independence of the CAA and a number of airlines, airports and other groups opposed it on the basis that it could compromise the clarity of the primary duty. The joint response from Board of Airline Representatives, the European Low Fares Airline Association and the British Air Transport Association put forward an alternative formulation which was “to take account of government policy and any guidance issued by the Secretary of State in the interest of security and international relations”. Gatwick airport was concerned about the effectiveness and stability of a regulatory regime in which direct Government intervention was a possibility and the RDAs thought the wording was vague and could be open to different interpretations.

3.58 British Airways felt that the government should not be able to impose developments on the market unless it was willing to pay for them. The CAA reiterated this view and proposed the following wording “to have regard to the NPS on airports”. The CAA felt that the NPS should guide the IPC, not provide a tool to alter the central function of economic regulation.

3.59 Support for the proposal came from a number of airport operators, who thought that the proposed duty provided the correct balance between the government and the CAA and did not compromise the clarity of the regulator’s primary duty towards consumers. BAA supported the proposal but thought that adopting a more general definition of government policy with respect to airport development would create useful flexibility and would maintain a degree of separation between regulatory and planning processes. Which? thought that the approach appeared to be sensible. A number of responses (e.g. the Tees Valley Joint Strategy Unit, the North East Chamber of Commerce and the Northern Way) were also in favour of the proposed approach particularly because of its potential role in supporting wider policy goals such as regional economic development.
Government’s decision

3.60 We still believe that the CAA should be required to have regard to guidance issued by the Secretary of State in relation to the economic regulation of airports. We do not believe such a duty would undermine the regulator’s independence as the CAA would be required to have regard to the guidance, they would not be required to follow it. In addition, we still believe that there is merit in clarifying the relationship between government policy on the delivery of airport infrastructure and the CAA’s decisions with regard to price regulated airports. However, stakeholder responses indicate that we need to clarify how the two processes will interact in practice and make it clear that the duty is not intended to undermine the independence of the CAA or compromise the clarity of its primary duty.

3.61 We agree that responsibility for scoping and designing an investment project to deliver capacity should remain with the airport operator and further that the system should not result in the regulator requiring delivery of an investment project that is not commercial. We also agree that the CAA’s decision on which investments should be incorporated into a given price control should depend on an assessment of which investments satisfy its primary duty to passengers (and would therefore occur in a competitive, well-functioning market). The intention of this duty is to ensure that where the CAA concludes that an investment included in for example, the NPS on airports is not consistent with its primary duty, its decision explains why this is the case.

3.62 In addition, having further considered the proposed wording in light of stakeholder responses, we think a duty “to have regard to” may be more appropriate than a duty “to assist in the delivery of”. This would be consistent with the wording used in other regulators’ duties on guidance and should provide some further clarification that the duty would not enable direct Government intervention in the regulatory regime. We have therefore decided that the CAA should be required:

“To have regard to guidance issued by the Secretary of State, as well as any National Policy Statement on airports.”

Supplementary duty on Better Regulation and consulting with stakeholders

Government’s proposal

3.63 We proposed that in performing its airport economic regulation functions, the CAA must have regard, in all cases, to the principles of Better Regulation. These principles state that regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, including any other principles appearing to the CAA to represent the best regulatory practice and to consult with stakeholders, including airlines. As a result a duty along the following general lines was proposed.
“to have regard to the principles of Better Regulation and any other principles appearing to represent the best regulatory practice, and to consult with stakeholders, including airlines”

3.64 There were no specific questions asked as part of the consultation in relation to this duty. However, question 6.8 asked a general question relating to all duties.

3.65 In addition to proposing that the CAA should have regard to the principles of Better Regulation, we also consulted on the proposal to extend the coverage of the Regulator’s Compliance Code to include the CAA’s airport economic regulation functions. This code was published by the Department for Business, Innovation and Skills (BIS) in December 2007 and aims to embed risk-based, proportionate and targeted approaches to regulatory enforcement among national and local regulators. Regulators whose functions are specified under a statutory instrument must have regard to the Code when exercising the specified functions. However, the economic regulators were all excluded and as a result only the regulatory functions of the CAA relating to safety and consumer protection are currently covered. The following question was put to stakeholders (question 8.7):

- The Government is considering applying the Compliance Code to CAA’s economic functions. Are you in favour of extending the coverage of the Code in this way? Please give reasons to support your views.

3.66 The consultation document also stated our intention to apply the provision of part 4 of the Regulatory Enforcement and Sanctions (RES) Act 2008 to the airport economic regulation functions of the CAA. This would require the regulator to:

- Review the burdens it imposes in fulfilling its obligations, identifying any that are unnecessary;
- act to remove any unnecessary burdens, subject to it being proportionate and practical; and
- report annually any action taken, including a timetable for removing the burden as well as explaining, where an unnecessary burden has not been removed, why removal would be disproportionate or impractical.

Consultation responses

3.67 Where stakeholders commented, there was generally support for the application of the principles of Better Regulation.

3.68 Responses to the proposal to extend the coverage of the Regulator’s Compliance Code to the CAA’s airport economic regulation functions were mixed. Birmingham Consultative Committee and a number of airports and airlines supported the proposal if it would achieve consistency of standards.

3.69 Although it did not expressly object to the proposal, BAA said that due caution should be exercised before the code is extended to the economic regulation functions of the CAA given, thus far, Parliament has not required other economic regulators to become subject to the code.
3.70 BA and the CAA did not support the proposal to extend the coverage of the Compliance Code to the economic regulation of airports. BA felt it was unnecessary given the proposed statutory duties and the CAA did not see a strong case for extending coverage. The CAA noted that the primary purpose of the code was to implement the recommendations of the Hampton report which did not cover any of the independent economic regulators. In relation to applying Part 4 of the Regulatory Enforcement and Sanctions Act to its airport economic regulation functions, the CAA noted it already has a strong track record of investigating areas where the regulatory burden could be reduced to ensure that economic regulation remains proportionate.

3.71 Responses on the duty to consult with stakeholders were mixed. BAA and the CAA considered that consultation was implicit in the primary duty, while a number of airlines and their representatives thought that the duty was not strong enough. BA felt that mere consultation of airlines and the discussion of them as stakeholders did not adequately recognise the legitimate interests of airlines as customers and as the best representative of the overall passenger experience. In its market investigation of BAA airports, the Competition Commission proposed that the regulator should take account of airlines’ views through an ancillary duty.

Government's decision

3.72 We remain of the view that the CAA, in discharging its airport economic regulation functions, should have a duty to have regard to the principles of Better Regulation. However, given the specific issues raised in the consultation regarding the CAA’s role as an economic regulator, and the fact that other economic regulator’s are not subject to the Code, we do not propose to impose statutorily the Compliance Code to its activities relating to the economic regulation of airports. However, the Government believes that there are aspects of the Code which may be relevant, and it is open to the CAA to consider whether to adopt any aspect of the Code as good practice.

3.73 Although we agree that appropriate consultation with stakeholders, including airlines is implicit in the primary duty, we believe that given its importance, this warrants explicit consideration in a supplementary duty. We believe it is important for the CAA to consult those parties which it believes are either materially affected by its decisions or which the CAA believes it is appropriate to consult. However, we also believe that the combination of a primary duty to passengers and a supplementary duty to consult with stakeholders, including airlines, provides the regulator with sufficient incentives to appropriately consult with airlines. Therefore we believe the CAA should be required:

“to have regard to the principles of Better Regulation and to consult with stakeholders, including airlines”.

3.74 The precise wording of the supplementary duty that will give effect to our policy intent will of course be subject to further input by the Parliamentary process.
3.75 Finally we confirm our intention to apply the provisions of Part 4 of the Regulatory Enforcement and Sanctions Act 2008 to the airport economic regulation functions of the CAA. This would bring the CAA in line with other economic regulators in the UK, which are also subject to part 4 of this Act.

Summary of key decisions

3.76 The existing four co-equal duties of the CAA will be replaced with a single primary duty which will require the CAA:

“To promote the interests of existing and future end consumers of passenger and freight services at airports in Great Britain, wherever appropriate by promoting effective competition”.

3.77 With supplementary duties (note the supplementary duty on financing activities is discussed as part of the overall financial package in chapter 5) which will require the CAA

i. “to have regard to the airport operator’s legal obligations to comply with applicable environmental and planning law”

ii. “to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently”.

iii. “to ensure that licence holders are able to finance the activities which are subject to the relevant licence obligations”

iv. “to have regard to guidance issued by the Secretary of State, as well as any National Policy Statement on airports.”

v. “to have regard to the principles of Better Regulation and to consult with stakeholders, including airlines”.

3.78 The precise wording of the CAA’s duties relating to its airport economic regulation functions will be subject to further input, including from Parliamentary Counsel and Parliament.
4. Designing a flexible, fair and effective enforcement regime

Introduction

4.1 The previous chapter explained how the Government proposes to give the Civil Aviation Authority (CAA) clear and focused objectives centred on the interests of passengers in performing its airport economic regulation functions. The CAA requires robust and flexible powers to meet its objectives. This chapter explains how through a new flexible licensing regime, with appropriate checks and balances, the CAA will be able to put in place requirements on airports subject to licences to meet its new duty to further the interests of passengers. This chapter also explains the Government’s proposals for effective and flexible sanctions to be available to the CAA to enforce licence conditions.

4.2 In the remaining sections of this chapter, we:

● Explain the decision to introduce a new proportionate licensing structure;
● set out the Government’s initial views on the licence conditions that will be included in the new licences;
● set out the process for developing the initial licences;
● explain the sanctions and enforcement powers that the Government intends to give the CAA, including with regard to breaches of the new licence conditions; and
● explain the decision to give the CAA concurrent competition powers for airport operators.

A proportionate licence structure

Government’s proposal

4.3 The Government’s consultation set out proposals for a new licensing regime for UK airports to allow more targeted and proportionate regulatory requirements consistent with the principles of Better Regulation. The proposed licensing regime was split UK airports into four categories:

● Tier 1 licences – These would be for airports with substantial market power and for which general competition law is unlikely to be sufficient
Designing a flexible, fair and effective enforcement regime to address the potential risks of abuse of market position and for which regulatory intervention is warranted. Currently Heathrow, Gatwick and Stansted airports fall into this category.17

- Tier 2 licences – These would be for airports with more than 5 million passengers per year (currently 10 UK airports in addition to those in Tier 1). These airports (and Tier 1 airports other than very small airports that met the criteria) would be covered by the provisions in the Airport Charges Directive (ACD), so Tier 2 licences will give permanent effect to the provisions of the ACD for airports not covered by Tier 1 licences.18 Currently apart from provisions necessary to ensure that the licence is effective, such as a revocation condition, the DfT is anticipating that the Tier 2 licences will only include provisions directly related to the ACD and the functions of Passenger Focus.

- Tier 3 licences – No airport would automatically be in this tier. The CAA would be granted the power to introduce licences at airports with less than 5 million passengers per year, and place them in Tier 3. The consultation explained that Tier 3 would be used when the CAA had good cause to do so, for example due to material complaints from passengers, freight users or airlines about poor performance. Assuming no airports were immediately placed in Tier 3 these proposals would initially mean that up to 42 airports that currently require permission to levy airport charges would not need an economic licence.

- Other airports – All other airports would not need a licence.

4.4 The decision about whether an airport was in Tier 1 would be taken by the CAA against a set of criteria that are based on the existing criteria for deciding whether an airport is designated or de-designated. The consultation proposed that the criteria be:

1. The airport operator, either alone or together with any other airport(s) in common ownership or control, has or is likely to acquire, substantial market power; and

2. Domestic and EC competition law may not be sufficient to address the risk that, absent regulation, the airport would increase and sustain prices profitably above the competitive level, or restrict output or quality below the competitive level; and

3. Regulatory intervention within the Tier 1 licence will deliver additional benefits for airport consumers (i.e. over and above competition law) that will exceed the costs or potential adverse effects of any regulatory intervention.

4.5 The criteria would be set out in primary legislation. The CAA’s decision as to whether an airport should be in or out of Tier 1 would be subject to an appeal to the Competition Appeals Tribunal (CAT).

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17 As discussed in Chapter 2, the Secretary of State committed that the review would not make changes to the basis on which the current price caps are set. Assuming licences are issued in the current price control period, the current price caps will therefore need to be included in the new licences (unless an airport is de-designated).

18 The main provisions of the ACD are explained later in this chapter.
4.6 A decision by the CAA to put an airport in Tier 3 would be subject to a merits based appeal to the CAT.

4.7 In addition to asking stakeholders whether they agreed with the overall approach to developing the new licence conditions, the consultation asked four specific questions about these proposals, which were (question 7.1):

- Do you agree with the proposed tiers for the licences, including the criteria and thresholds that will be used to determine which tier an airport will be in?
- Do you agree that the criteria for determining whether an airport has a Tier 1 licence should be enshrined in Primary Legislation?
- Do you agree that the regulator should retain the option of regulating small airports that have substantial market power with a Tier 1 licence, including a price control, subject to the satisfaction of the criteria set out above and the appeals process?
- Do you agree that the regulator should be able to impose a Tier 3 licence on certain small airports that would allow market power at these airports to be addressed whilst stopping short of price control?

Consultation responses

Tier 1 and 2 licences

4.8 There was wide support amongst a range of stakeholders, and almost no objection, to the proposal for Tier 1 and 2 licences. Those respondents who expressed a general concern about the proposal, were concerned about a potential increase in the regulatory burden (for example the responses of the Regional Development Agencies).

4.9 A range of views were expressed about the appropriate threshold for Tier 2 licences. Birmingham Airport noted that the UK had a higher proportion of airports with more than 5 million passengers than most other EU countries who would also be implementing the ACD, and suggested a market share based test may be more appropriate. Peel Airport Group proposed that an additional Tier 2A should be introduced for airports moving between Tier 1 and 2 to give the CAA more scope to monitor changes in market conditions and competition.

4.10 The CAA also suggested that the coverage of the Tier 2 licences could be extended to also cover other EU Directives and Regulations applying to airports.

Tier 3 licences

4.11 There was much greater debate about the appropriateness of Tier 3 licences, with views ranging from the Campaign to Protect Rural England that argued that all airports should be subject to a licence to address environmental issues, to BAA, a number of smaller airports and the CAA questioning the need for Tier 3 licences. The CAA believed that any concerns that the DfT seemed to intend to address with this additional Tier would be addressed most appropriately with a Tier 1 licence. In addition, the proposed Tier 3 licence afforded the regulator extensive discretion without the necessary checks and balances which could increase
regulatory risk for small airports, e.g. through no clearly defined criteria for imposing a Tier 3 licence.

The criteria for deciding whether an airport is in Tier 1

4.12 Amongst those who commented, there was broad support for the proposed criteria and the approach of considering an airports’ market position and power, and then the costs and benefits of regulation. The main comments from two respondents (British Airways and the CAA) focused on the detailed drafting of the criteria, and are summarised below. No other respondents made detailed comments. British Airways:

- Supported the first criterion;
- suggested that the word “will” should be replaced by “could” or “is likely to” in the third criterion so it would read that regulatory intervention, “could/is likely to deliver additional benefits for airport consumers...”.
- British Airways (BA) argued that this approach avoided the regulator having to make difficult forecasts about the future nature and effects of economic regulation; and
- considered that the second criterion was redundant in the light of the third criterion. It considered that competition law was unlikely to ever be an effective remedy for airports with substantial market power or dominance.

4.13 The CAA’s comments were that:

- The DfT should indicate that Tier 1 regulation is to apply where an airport has a market position somewhat stronger than dominance, as many entities in the UK might hold such a position, but are only subject to general competition law;
- the DfT should indicate that Tier 1 regulation could only be justified where there was a significant risk of abuse (given the deterrent effect of competition law) and there were expected to be significant effects;
- DfT should clarify that smaller airports would be less likely to pass the tests than larger airports given that it would be harder for the benefits to exceed the costs; and
- the words “may not be” should be changed to “is unlikely to”, so it would read that competition law, “is unlikely to address the risk of an airport abusing its substantial market power”.

4.14 A number of respondents (primarily airlines) argued that if an airport is in Tier 1 it should automatically face a price cap or control, and there should not be flexibility for the CAA to propose price surveillance or monitoring rather than a price cap.

4.15 Amongst those respondents expressing an opinion there was broad support for the proposal to enshrine the criteria in primary legislation. This approach had the advantage of providing certainty about the basis on which decisions about whether an airport is in Tier 1 would be taken. BA was opposed to this, mainly because it was concerned that such an approach would limit flexibility to adjust the criteria as circumstances changed.
Government's decision

Tier 1 and 2 licences

4.16 The responses to the consultation have not raised any issues that lead the Government to change its view on the proposals for Tier 1 and 2 licences. Stakeholders broadly supported the new regime as allowing more flexible and proportionate regulation of airports, while also facilitating the implementation of the ACD. We do not consider that the new regime will significantly increase the regulatory burden on Tier 1 airports, which already face quinquennial price control reviews and other regulatory scrutiny. While there will be some increase in the regulatory burden for Tier 2 airports, this primarily relates to complying with the ACD rather than the introduction of a licensing regime. As noted earlier, it will be necessary to give effect to the ACD through a Statutory Instrument if, as expected, the licensing regime is not in place before the deadline for transposing the ACD.

4.17 It is not clear what advantage would be gained from a Tier 2A licence as suggested by Peel Airports Group, as the CAA would have the flexibility to tailor a Tier 1 licence so that it is appropriate for the individual airport operator being licensed. As part of this, the CAA will have the flexibility to use alternative forms of price regulation (including more light touch forms of regulation such as monitoring or price surveillance) for airports with Tier 1 licences. Such monitoring or price surveillance would be used to inform a decision on whether a price control should be introduced at a later date or not at all.

4.18 While a small number of respondents suggested alternative thresholds for a Tier 2 licence, the 5 million passenger throughput is consistent with the ACD. A market share based test as proposed by Birmingham International Airport would not ensure that the licence regime complies with the ACD, and could create overlap with the purpose of the assessment for Tier 1 licences, whose first criterion considers whether an airport has substantial market power.

4.19 While the Government recognises the importance of addressing environmental issues, we do not believe that requiring all airports to have a licence for the purposes of economic regulation, when there are many other aspects of statute and regulation that address environmental issues, is appropriate or proportionate. Respondents to the consultation that advocated this approach did not explain what additional provisions would be covered in such a licence that are not otherwise addressed in other provisions.

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19 Currently apart from provisions necessary to ensure that the licence is effective, such as a revocation condition, the DfT is not anticipating that the Tier 2 licences will include any provisions not directly related to the ACD.
The proposal for Tier 1 and Tier 2 licences is confirmed, with the threshold for Tier 2 licences being the 5 million annual passenger numbers used in the ACD.

Tier 3 licences

4.20 The option for Tier 3 licences was included in the proposals to provide flexibility for the CAA to licence airports with less than 5 million passengers per year and which did not meet the criteria for a Tier 1 licence. CAA would have had discretion (subject to checks and balances) whether to place such airports in Tier 3. The consultation set out some potential reasons for placing airports in Tier 3, including material complaints received from passengers, freight users or airlines about poor performance of that airport. While some circumstances for imposing such a licence were set out in the consultation, they were not intended to be exhaustive.

4.21 The Government recognises that there was very limited support for Tier 3 licences from stakeholders. Therefore, we have reviewed again the rationale for Tier 3 licences and considered whether the additional flexibility of this approach is outweighed by potential disadvantages, including regulatory uncertainty and duplication of existing powers. The Government recognises that there are a range of other powers that the CAA could use to address concerns about small airports, including considering whether they met the criteria for a Tier 1 licence, general competition law and consumer protection powers (the last two of which are also available to the OFT). The CAA has substantial flexibility as to the type of price and service quality regulation it places on a Tier 1 airport, such that Tier 1 licences could effectively be used to address concerns about the substantial market power of a small airport. The Expert Panel considered that there may be circumstances in which it was useful to have Tier 3 licences, and was concerned that it was a big step for a small airport to move from no licence to a Tier 1 licence. It considered that there may be consumer protection measures that could be included in a Tier 3 licence for some airports. The Government also considered other options, including for the Secretary of State to take a reserve power to allow the issuing of Tier 3 licences. However, overall the Government now considers that the balance between flexibility through allowing for Tier 3 licences to be issued, and the costs, including regulatory uncertainty and potential duplication of powers, suggest that it is not appropriate to retain the option for Tier 3 licences.

We have decided that the option for Tier 3 licences should not be pursued, on the basis that it is unlikely that circumstances would arise where we would want to licence an airport that did not meet the criteria for a Tier 1 or 2 licence, i.e. small airports would only be regulated if they met the Tier 1 criteria.

4.22 As a consequence of the proposals for the new licensing regime, up to 42 airports that currently require permissions to levy charges from the CAA will no longer require such permissions or an economic licence. However, another – unintended – consequence of airports no longer holding permission to levy charges is that they will lose their status as statutory undertakers and the rights and obligations conferred upon them as a result. We explain later in this chapter how we intend to retain the right for these airports to be statutory undertakers.
Reforming the framework for the economic regulation of airports: Decision Document

4.23 The consultation document focused on the transposition of the ACD which meant that Tier 2 licences were proposed to apply to airports with more than 5 million passengers per year. However, there are other EU laws, relating to passengers with reduced mobility and ground handling, that apply to airports with less than 5 million passengers. The CAA argued that Tier 2 licences which would allow the provisions of the ACD to be implemented, could also provide a flexible mechanism by which other EU laws could be implemented with the regulatory framework designed in a way that also allows for future EU laws to be implemented through licences.

4.24 EC Directives in this area are usually implemented by Statutory Instruments which give the CAA powers and duties in order that effect is given to Directives. The Government is satisfied that this approach works effectively and it is not clear that the implementation approach should be brought within licences for economic regulation. Given that the provisions of the ACD relate to information and consultation provisions between airports and airlines, it more closely relates to the main economic regulation of airport functions that will be addressed by the Tier 1 licence than other laws. The DfT will continue to consider in the future the best approach to implementing any further EU laws.

The criteria for deciding whether an airport is in Tier 1

4.25 The Government is encouraged that there is very broad consensus about the form of the criteria and their broad content. These criteria have already been the subject of much debate, including as regards decisions concerning the non-designation/designation of Manchester and Stansted Airports. It has also been necessary to satisfy ourselves that an approach reflected in the criteria will adequately implement the ACD requirements regarding the assessment of whether airports are subject to effective competition. The Government is content that a statutory test founded on these criteria will implement the ACD. In particular, we are content that the reference to airports being subject to effective competition in the ACD is, in practice, equivalent to whether an airport has substantial market power.

4.26 Consistently with the alternative to establishing a right of appeal in relation to all charging decisions, as envisaged by Article 6(3) and (4) of the ACD, we have considered if the process for deciding whether to impose a price control on an airport operator under the new regulatory framework meets the requirements of Article 6(5) of the ACD. For the purposes of that ACD, we consider a determination as to whether or not price control is warranted, founded on a consideration of whether the competition environment at an airport justifies regulatory intervention, to be in line with the associated provisions of the ACD.

4.27 In broad terms wording changes to the proposed criteria, suggested by BA are likely to weaken the third criterion and make it more likely to be met. The criterion was intended to be a robust assessment of the costs and benefits of regulatory intervention and we see no reason to weaken its strength. We consider that the criteria are a logical progression and consideration of whether competition law can address concerns about substantial market power is an important step before considering the costs and benefits of price regulation.
4.28 With regards to the CAA’s suggestion that Tier 1 licences should apply only where an airport has a position stronger than market dominance, we are not minded to change the criteria given that we do not think this would conform to the provisions of the ACD which are an alternative to establishing a decision-specific appeals mechanism. In any case, the second criterion is intended to address the CAA’s concern given that it explicitly recognises the possibility that competition law may be sufficient to address any competition issues. However, in relation to the second criterion, we agree that “may” is arguably too weak and unclear and does not therefore properly convey our policy intent.

4.29 We are not proposing to provide any formal guidance about the likelihood of small airports meeting the criteria, although given that no small airport has been designated under the Airports Act 1986 for price regulation, we recognise that the CAA is stating a position that has historically been the case. While it will not be a requirement for the CAA to issue guidance about how it will interpret the criteria, it would be able to provide such guidance on a non-statutory basis if it considered that this better fulfilled its objectives and functions, including meeting the principles of Better Regulation.

4.30 Our conclusions as to when an airport should have a Tier 1 licence, which will be reflected in legislation put before Parliament, is that this should happen when:

1. The airport operator, either alone or together with any other airport(s) in common ownership or control, has or is likely to acquire, substantial market power; and

2. Domestic and EC competition law would not be sufficient to address the risk that, absent regulation, the airport would increase and sustain prices profitably above the competitive level, or restrict output or quality below the competitive level; and

3. Regulatory intervention within the Tier 1 licence will deliver additional benefits for airport consumers (i.e. over and above competition law) that will exceed the costs or potential adverse effects of any regulatory intervention.

4.31 The exact form of wording will depend on the parliamentary process.

4.32 We are not accepting the proposal of some respondents that Tier 1 airports should have an automatic and mandatory price cap, and instead the CAA should have the flexibility to impose a range of price regulation options, including monitoring or surveillance. Such monitoring or surveillance could be used to see whether price capping should be introduced at a later date or not at all. This is consistent with the approach of the Review to provide more flexibility in the airports regulatory framework (subject to appropriate checks and balances) for regulation to be tailored to the appropriate market circumstances. As the Government is not proposing to have Tier 3 licences, flexibility about the provisions of Tier 1 licences that could cover small airports is potentially more important. As noted above, the CAA has substantial flexibility as to the type of price and service quality regulation to

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20 See article 6(5)(b).
place on Tier 1 airports, and the third criterion that recognises that there are costs and benefits to different forms of price and service quality regulation recognises the need for this flexibility. The Government considers that the flexibility for the CAA to decide whether or not price-capping is warranted for all Tier 1 airports is consistent with the provisions of the ACD.

4.33 While recognising BA’s concern that enshrining the criteria in primary legislation creates a risk that if the criteria turn out to be inappropriate over time, it is difficult to change them, we consider that the decision about whether an airport is in Tier 1 is very significant and enshrining the criteria in primary legislation provides much greater certainty about the basis of this assessment for all stakeholders. The criteria have also been consulted on in two substantive consultations, as in addition to the March 2009 consultation for this review, the criteria were consulted on in preparation for the decisions in 2008 about whether to designate/de-designate Manchester and Stansted airports. We also consider that those processes showed the conditions, subject to drafting amendments discussed above, to be robust.

The criteria for deciding whether an airport has a Tier 1 licence will be enshrined in primary legislation.

Licence conditions

Government’s proposal

4.34 For Tier 1 licences the consultation identified the following obligations that it expected would be included in the licence:

- Price regulation – Initially that would be the current price control, but could in future be different forms of price regulation.

- Measures to enhance the financial robustness and resilience of the airport operator – The types of measures discussed in the consultation document are similar to the ring fence conditions in energy, rail and water sector licences.

- Obligation to consult with airlines and other stakeholders on future plans for investment in, and the operation of, the airport.

- Obligations to report on environmental performance – The purpose of the reporting was discussed in the consultation and this proposal is discussed in more detail later in this chapter.

4.35 In addition to these topics, the consultation identified the following provisions as being likely to be included in Tier 1 licences subject to the specific circumstances of an airport. These are:

- Obligation to comply with service quality standards – Initially this would be the current service quality incentives for the designated airports.

- Capacity utilisation limits – These provisions would help ensure that delays were kept to an efficient level.
4. Designing a flexible, fair and effective enforcement regime

- Measures to hold the airport operator to account for the delivery of agreed investment outputs, including investment in capacity.
- Regulatory accounting information and other information as required for the effective operation of the Constructive Engagement process.

4.36 The consultation also considered the sanctions that could apply for breach of licence conditions. Some of these sanctions may need to be included within licence conditions, such as the provisions for revocation of a licence.

4.37 The consultation asked stakeholders views on (questions 7.3 and 7.4):

- The conditions that should be included in the licences for each tier.
- The likely scale and value of costs associated with implementing the introduction of the proposed licensing regime?

Consultation responses

4.38 In general, the proposed conditions were accepted although the responses indicated that more detail would be welcome. For example, Birmingham International Airport noted that the conditions represented a broadly reasonable starting point but that further detail would be welcomed. BAA also felt that a significant level of further work was required in the development of obligations which Tier 1 airports may be required to meet. Gatwick Airport felt that the proposals made were a relatively standard set of licence conditions with useful precedents in other regulated sectors. Gatwick Airport expected that it would be the exact wording of these licence conditions that would be the subject of detailed scrutiny later in this process.

4.39 In some cases, more specific concerns were raised with the licence conditions. The airlines and their representatives were concerned about the potential for loose regulation under Tier 1. The joint response from the Board of Airline Representatives, European Low Fares Airline Association and the British Air Transport Association expressed the view that any airport in Tier 1 should face pre-emptive price caps. Board of Airline Representatives UK, British Airways, easyJet, International Air Transport Association, Thomson Airways, Virgin Atlantic and Stansted Airport Consultative Committee agreed with this. The Local Authorities’ Aircraft Noise Council did not think that the proposed framework offered reassurance to those concerned about the environmental impact of Heathrow airport in particular.

4.40 Some responses raised particular conditions that they would like to be included in licences. The 2M Group of Councils felt that licences should only be granted once passenger and environmental standards had been satisfied. Stop Stansted Expansion asked for two obligations to be considered. First, all licence holders should reduce and minimise the adverse impacts of their activities on the environment and local communities and second, Tier 1 and 2 licence holders should be able to finance the activities which are subject to relevant licence obligations. The Scottish Government raised a question about whether the need for more ambitious route development could form a licence condition under the new regime.
4.41 British Airways’ response presented a potential list of licence conditions. Under the proposal, Tier 1 airports would have all licence conditions while the other two tiers would only be subject to some of these conditions. The particular conditions considered by British Airways to be necessary were:

- Coverage/scope of the licence;
- ring-fencing and intra-group transactions, market testing and contracting-out;
- provision of adequate capacity and infrastructure to meet demand and service levels, including a duty to ensure adequate supplies of fuel;
- price regulation, need for cost-based determinations and charging structures;
- business plans, master plans and investment plans;
- accountability, transparency and regulatory reporting;
- disposal of assets and change of ownership;
- insolvency and special administration;
- licence review procedures;
- appeals;
- relationship with Secretary of State;
- corporate governance;
- service quality;
- credit rating requirement;
- consultation requirements; and
- environmental reporting.

4.42 In terms of determining the types of conditions, the CAA considered that to ensure flexibility, the regulator should retain full discretion over the type of licence conditions to be included in the Tier 1 licences. However, the CAA accepted that the mandatory imposition of some form of price regulation (that could also take the form of price monitoring) could represent an appropriate minimum requirement to delineate a Tier 1 licence from a Tier 2 licence. The Office of Fair Trading also thought that the new framework should provide sufficient flexibility to the regulator to intervene by way of licence conditions.

**Government’s decision**

4.43 Overall the Government’s intention is that the licence conditions will focus on matters associated with economic regulation or implementing the ACD. This scope for the licence conditions will be formally proposed in the legislation presented to Parliament.
4.44 The Section 16 request (under the Civil Aviation Act 1982) for advice from the CAA about the drafting of some licence conditions, which is published alongside this decision document, explains the conditions that the Government currently regards as appropriate to include in the initial Tier 1 licences. In addition to additional licence conditions e.g. financing and consultation, this includes any further conditions that would be necessary to meet the new duties of the CAA. Furthermore, the likely nature of the conditions regarding financial resilience provisions and consultation and information provisions are discussed elsewhere in this decision document. The Government is satisfied that its proposals will include sufficient measures to enable the CAA to hold the airport operator to account for the delivery of agreed investment outputs, including investment in new capacity.

4.45 The Government does not consider that it would be appropriate to include detailed environmental provisions in the licences as such provisions are generally implemented through other measures. Similarly the Government is not currently proposing to include conditions on capacity utilisation limits in the licences. However, this would not preclude the CAA from introducing provisions to keep delays to an efficient level in the future, if they believed such conditions would be consistent with their statutory duties.

4.46 The Government’s initial views on the proposed conditions can be grouped into three broad categories:

- **The basic requirements of any licence** – This includes definitions of key terms, coverage of the licence, provisions to pay licence fees, obligations to provide information to the regulator and revocation conditions. As noted in the Section 16 request many of these provisions are present in the licence conditions found in other sectors.

- **Transposition of existing provisions** – This includes the current price caps that apply to Tier 1 airports, public interest conditions (including the Service Quality Requirements) and regulatory accounting information. Consistent with the commitment at the beginning of this review the current price caps for Heathrow, Gatwick and Stansted airports will form part of the new licences if Tier 1 licences are issued in respect of those airports during the current control period.  

- **New provisions** – This includes provisions to help ensure the financial resilience of airport operators, appropriate consultation and information provisions and other conditions necessary to give ongoing effect to the ACD, which are discussed below.

4.47 It is important to note that the requirements of the ACD apply to Tier 1 and 2 airports, so it will be necessary to ensure that all of the provisions of the ACD relevant for Tier 2 licences, which are discussed below, are also included in the Tier 1 licences. As discussed further below the Government is proposing that only the Secretary of State would have the power to modify those licence conditions, or aspects of licence conditions, which give effect to the ACD.

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21 Unless of course an airport is de-designated during the current price control period.
4.48 Consistent with the consultation document we are proposing that primary legislation will require that all Tier 1 licences include provisions for some form of price regulation, financial resilience, and information and consultation licence conditions. While the conditions will be required under primary legislation the detail of the conditions will be subject to the processes for changing licence conditions discussed elsewhere in this chapter.

4.49 Since the consultation, stakeholders have raised with the DfT questions about whether the licences will contain any time limit. An airport which satisfies the test for a Tier 1 or Tier 2 licence should have the appropriate licence. It should be possible for an airport which undergoes a change in its competitive environment, or a change in its passenger numbers, to be reclassified for the purposes of the licensing structure. The government’s legislative proposals will contain appropriate provision to enable reconsideration of the licensing status of an airport where this is appropriate. The Government’s current preference is that this happens by way of a review of a licence that has no built-in time limit, but as part of the legislative process we will also consider the option of this happening through renewal or non-renewal of a time limited licence.

Environmental reporting

Government's proposal

4.50 The consultation document proposed that Tier 1 and Tier 2 airports should be required to publish an annual report setting out their environmental performance; what the likely consequences of their Masterplans are; and what further steps they intend to make to mitigate the environmental impacts of their airport. The purpose of such a licence condition would be to improve transparency and accountability for an airport’s environmental actions and to provide a basis for on-going discussions with interested stakeholders and the local community. The consultation document asked stakeholders the following question (question 8.6):

- Do you agree that Tier 1 and 2 airports should be required to submit an annual report to the CAA and other environmental regulators about their environmental performance? Are there any specific requirements that you consider should be in such a licence condition?

Consultation responses

4.51 A number of respondents (including a couple of individual airports and an airline and airport representative) were opposed to having a licence condition requiring Tier 1 and Tier 2 airports to publish an annual report on their environmental performance.
4. Designing a flexible, fair and effective enforcement regime

4.52 Birmingham International Airport Consultative Committee noted that airports already produce annual accounts and reports to the business community and to their local airport consultative committees that contain environmental reports. BAA and Gatwick Airport commented that they already report on their environmental performance and Gatwick further noted that this could be used for the CAA and other environmental regulators so long as one set of information provision is agreed between the various regulators to avoid duplication.

4.53 The North East Chamber of Commerce was concerned that requiring Tier 1 and 2 airports to submit an annual report on environmental issues would impose an additional burden, while the additional benefits were unclear. The Air Transport Users Council (AUC) thought that the environmental reporting requirement might be better taken care of separately from economic regulation. British Airways also thought that the purpose of such a report was unclear because CAA was not the environmental regulator. The CAA noted that the consultation paper did not discuss the content of such reports, the costs and benefits of the requirement, or the possibility of distorting competition should environmental obligations be placed on some airports and not others.

4.54 Support for the proposal came from a range of respondents including the Scottish Government, Northern Way, easyJet, Stop Stansted Expansion, Campaign to Protect Rural England and Unite. However, only two responses discussed the requirements that should be included in such a licence condition: easyJet noted that it should cover local environmental issues such as noise and local air quality; and Unite were of the view that it should refer to the volume of carbon dioxide emissions and methods for getting to the airport.

Government’s decision

4.55 The consultation indicated that a number of airports already publish information on their environmental performance, including on a voluntary basis, but it did not provide a clear picture of exactly what information is currently published. Therefore the additional costs that would be imposed on airport operators as a result of them publishing an annual report on their environmental performance are not clear. The purpose of such reports would be to improve transparency and accountability for an airport’s environmental actions and to provide a basis for on-going discussions with interested stakeholders and although some stakeholders supported the proposal, we do not have any evidence on the scale of the benefits associated with such a requirement. As a result, we are unable to reach an informed view as to whether the benefits of this proposal would outweigh the additional costs imposed on airport operators. In light of this we are not proposing that Tier 1 and Tier 2 airports should be required to publish an annual report on their environmental performance as part of the package of reforms to the framework for the economic regulation of airports.
However, the Government is currently consulting separately on a number of proposed reforms to the CAA’s wider regulatory framework, one of which is to provide the CAA with a power to enable it to obtain information in line with its proposed general objectives. Such a power should facilitate the publication of information on an airport’s environmental performance, if the CAA was convinced (after consulting with stakeholders) that the benefits would outweigh the costs. Therefore, although we are not introducing this requirement as part of the reforms to airport economic regulation, the proposed wider reforms to the CAA’s regulatory framework may allow it to introduce similar requirements in the future.

Licence conditions arising from the Airport Charges Directive (ACD)

Government’s proposal

From Spring 2011 airports across Europe with more than 5 million passengers will be required to act consistently with the provisions of the Airport Charges Directive (ACD). In 2008 there were 13 UK airports with more than 5 million passengers – Heathrow, Gatwick, Stansted, Manchester, Luton, Birmingham, Edinburgh, Glasgow, Bristol, Newcastle, Liverpool, Nottingham East Midlands and Belfast International.

The consultation explained that the ACD sets a common framework about the principles of how airport charges are to be established and the associated relationship between airports and airlines. Some of its key provisions are:

- Creation or appointment of an independent regulator in each Member State to ensure the Directive’s effective application.
- Consultation – Airport managing bodies have to consult ‘airport users’ at least once a year on the level and structure of airport charges, unless agreed otherwise following a consultation, or set out in a multi-annual agreement. Airport managing bodies also have to consult airlines before plans for new infrastructure projects are finalised.
- Information transparency – As part of the consultation process, airports have to provide information on the total costs and revenues in relation to airport charges, as well as the method used for setting charges and the services provided in return for the charges. Airlines also have to provide information about their expected use of the airport and requirements.
- Non-discrimination – Airport charges must be non-discriminatory amongst ‘airport users’, in line with Community law. However, express provision is made for the ‘modulation’ of charges for issues of public and general interest including environmental issues.

We are consulting separately on proposals to replace the CAA’s current general statutory remit with new general objectives which would require the CAA to: pursue the reasonable interests of consumers; secure a high standard of safety; and have regard to environmental factors and seek environment improvements where possible and appropriate. The rationale for excluding the CAA’s airport economic regulation functions from these general objectives is discussed in Chapter 3.
4. Designing a flexible, fair and effective enforcement regime

- A right of appeal for an airline – Under certain circumstances, to the independent regulator if it does not agree proposed changes to the level and structure of airport charges. Great Britain intends to use the derogation in the Directive that permits Member States not to implement the right of appeal if in their own systems of airport regulation the independent regulator, i) sets or approves airport charges (or price caps) or ii) examines if airports are subject to effective competition and, if warranted on the basis of that examination, introduces setting or approval of charges or price caps.

4.59 The consultation explained that the Government intended to give permanent effect to the ACD through the proposed new licensing regime. The consultation asked stakeholders (question 7.2) whether they agreed with the principle of using the proposed licence regime for the economic regulation of airports to implement certain aspects of the ACD?

Consultation responses

4.60 Of the respondents that commented, there was generally support for the use of the licensing regime to implement the ACD. The Air Transport Users Council thought that using the licensing scheme to implement the ACD appeared to be logical. The Airport Operators Association, British Airways, easyJet, Gatwick Airport, Manchester Airports Group, Newcastle International Airport and Which? made similar comments.

4.61 BAA supported the proposal that the Tier 2 licence conditions relate to the ACD except for the proposal to give airlines a right of appeal to the regulator on proposed changes to the structure or level of airport charges. Belfast and Cardiff International Airports thought that there appeared to be little in the way of justification as to why the ACD should not be introduced through the existing framework. One airport group felt that in general, the proposal to build a new economic regulatory regime around the ACD was sensible but Peel Airports Group had some concerns about the potential information costs.

Government’s decision

4.62 The Government continues to believe that the new licensing regime is the most proportionate and effective way to give permanent effect to the ACD. In order to make use of the derogation from the right of appeal in the ACD, DfT has considered if the new regulatory framework for airport economic regulation meets the necessary conditions in the Directive. An important part of this is whether the criteria for determining if an airport should have a Tier 1 licence (as discussed above) and so be subject to economic regulation, is consistent with the Directive’s requirement that the independent regulator examines regularly if an airport is subject to effective competition and then acts, wherever warranted, to introduce price control. We believe that the test for a Tier 1 licence is for all practical purposes the same as a test for effective competition, so allowing Great Britain to make use of the derogation in the Directive. Licence conditions also seem an appropriate and straightforward way of implementing the other ACD requirements. The ACD has to be transposed into Member States
domestic law by 15 March 2011. The DfT’s firm intention is that the ACD’s provisions directly relating to airports should be implemented permanently through licence conditions. However, there is uncertainty about when a Bill to implement the conclusions of this review will receive Royal Assent and also about when the further work necessary to implement it in full will be completed. Given this, there is a significant risk that Tier 1 and Tier 2 licences will not be in place by March 2011, which would leave Great Britain in breach of its obligations under the ACD. As an interim measure in order to meet the transposition deadline, the Department plans to introduce new secondary legislation to implement the ACD in Great Britain. Our aim is to consult on this legislation in draft in Summer 2010.

4.63 The Government anticipates that the licence will be used to put in place most if not all of the obligations on airports required by the Directive and we also propose that only the Secretary of State would have the power to modify the licence conditions which give effect to the ACD. So the minimum requirements of the ACD may be set out in separate licence conditions that can only be modified by the Secretary of State.

The Government has decided to implement permanently the obligations imposed on airports in the ACD through the new licensing regime. Only the Secretary of State would have the power to modify licence conditions required to give effect to the ACD.

Developing the initial licence

4.64 In the Consultation we set out our intention that the initial licences should be issued by the Secretary of State after the passing of legislation by Parliament. Given the importance of the initial licences in giving effect to Government’s policies for the new regulatory framework we consider it is appropriate for the Secretary of State to issue the initial licences. The Secretary of State has, alongside this decision document, sent the CAA a request under section 16 of the Civil Aviation Act 1982 requiring appropriate advice and assistance to begin the process of drafting licence conditions.

4.65 After considering the CAA’s advice the Government may publish early drafts of the potential form of the licences for stakeholders and Parliament to see when considering the parliamentary bill to bring these proposals into place. Once royal assent has been given to the legislation significant further work will be required to develop the final form of the licenses consistent with the statutory duties in the final legislation. The Government expects to hold one consultation with all stakeholders about the form of the new licences, but the timing of this consultation will depend on the parliamentary process. While the Secretary of State intends to take a power to issue the initial licences, the Government will continue to draw on the CAA’s expertise during the development of the licences.
Changing licence conditions

Government’s proposal

4.66 The Consultation set out proposals for the CAA to be the sole body with the formal right to initiate changes to licence conditions, although other parties could make suggestions to the CAA about appropriate modifications to the licence conditions. If the CAA decided it was appropriate to seek a modification to a licence then two processes would be open for the CAA to follow:

- Where the CAA proposed to change the licence conditions for only one licence holder, e.g. the price regulation arrangement for a particular Tier 1 airport, it could make the change after agreement with the airport, and subject to any appeal by other parties with a right of appeal.

- Where the CAA proposed to change the licence conditions for all holders of Tier 1 or Tier 2 licences it could seek a collective licence modification. Partly drawing on experience in other sectors, the consultation proposed that this would have effect if 80% of affected airports and airports accounting for 80% of passengers in the previous year supported the change. The consultation also discussed the possibility of using a 50% rather than 80% threshold for collective licence modifications.

4.67 The Consultation also proposed that the Secretary of State have the right to refer licence condition changes to the Competition Commission for consideration even where they have been agreed by the licensee.

4.68 The Consultation asked for comments on the proposed process for modifications to licence conditions, and asked three further specific questions (question 7.5):

- We would particularly welcome comments on the proposed process for collective licence modifications.

- Do you agree that in a reformed regulatory regime the Secretary of State should retain the right to refer changes to licence conditions, even where agreed by the licensee, to the Competition Commission? Is this an appropriate scope for an intervention power for the Secretary of State?

- Do you agree that where a proposed change of licence condition would apply identically to a group of airports that this change would come into effect if it was accepted by 80% of these airports representing 80% of total passenger numbers across the group?

Consultation responses

4.69 There were some comments on the potential for collective licence modifications where agreement is reached between 80% of affected airports. Birmingham International Airport, London City Airport, Manchester Airports Group and Newcastle International Airport supported the proposed 80% threshold for changes to identical licence conditions across a group or tier of airports.
4.70 The Air Transport Users Council thought that the figure of 80% should be high enough to represent a genuine consensus between airports. However, the Air Transport Users Council did note that the concept of a “group” licence term was at odds with the overall objective of regulation tailored to the circumstances of individual airports. British Airways thought that the 80% acceptance threshold for licence modifications seemed high because it could effectively give veto to the largest airports. British Airways suggested 65% as an alternative.

4.71 The CAA questioned whether there would be any type of licence condition that would be subject to such an approval mechanism, as all Tier 2 licence conditions would be required by either the DfT or the ACD, and all additional Tier 1 licence conditions would be imposed either on a mandatory basis as required by the DfT or on an individual basis.

Government’s decision

4.72 There were no substantive comments on the right for the CAA to initiate proposed changes to the licence conditions, so that aspect of the proposal is being retained. It will remain open for other stakeholders to suggest new or modified licence conditions to the CAA.

4.73 The CAA will have the power to propose a modification to individual licences, and if the airport concerned does not accept the proposed modification, there would be a right of appeal to the Competition Commission by way of an investigative procedure. We have also decided to provide the Secretary of State with the power to refer changes to licence conditions to the Competition Commission even where they have been agreed by the licensee. The Competition Commission would then investigate the need for the licence modifications. This power is broadly consistent with the position in most other regulated sectors, but the Government expects that it would be a rarely used power. We proposed in the Consultation that the Secretary of State should retain a power to refer future licence modifications to the Competition Commission, even where the licensee agreed to their imposition. We believed this would provide a useful check on regulatory decisions.

4.74 The Consultation noted our view that a stronger power to intervene would not be appropriate as we recognise the benefits independent regulation provides in terms of certainty for investment and therefore wanted to limit and restrain the scope for ministerial intervention. Few respondents commented on this aspect of the proposals. As discussed in Chapter 6 the passenger representative body, Passenger Focus, and the Secretary of State could also appeal against an agreed licence modification. The proposals for appeals regarding licence modifications are discussed in chapter 6 of this document.

4.75 A process for Collective Licence Modification will allow the CAA to propose, and subject to the appropriate checks and balances, ensure that where appropriate all licence holders in a particular tier are subject to the same conditions, which will help ensure that administrative costs of implementing different licence conditions are minimised. The DfT is not intending that all licence conditions are necessarily mandatory or that the CAA would
lack power to amend all conditions (other than the mandatory ACD conditions). Therefore, while in many cases the conditions may be unlikely to be amended there may be circumstances where a Collective Licence Modification is appropriate as the best way to ensure consistency of provisions across licences.

4.76 Given this desire, we recognise that it is difficult to identify an ideal threshold for the Collective Licence Modification procedure. On the one hand we want the threshold to be sufficiently high that changes only go through if there is a broad consensus that the modification is appropriate. Conversely, we do not want the threshold to be set in a way that is likely to give one or a small number of airports an effective veto over change. We are also conscious that airports' passenger numbers are not static in absolute or relative terms, and therefore, any assessment of which airports may have strong powers to veto change based on current passenger numbers may not be relevant in a few years. **Therefore, we have decided to retain the 80% threshold proposed in the consultation, with a collective licence modification requiring the consent of 80% of affected airports and those airports representing 80% of total passenger numbers across the group of affected airports.** This relatively high hurdle for collective licence modifications also recognises that if the CAA felt sufficiently strongly about a proposed modification it could refer the matter to the Competition Commission if there was not sufficient agreement from the affected airports, so no airport(s) could veto permanently any licence modification that the CAA and Competition Commission considered appropriate.

Sanctions and enforcement of licence conditions

**Government’s proposal**

4.77 In the consultation, the DfT considered the sanctions that should be available to the CAA in its role as regulator in relation to the enforcement of licence conditions. The DfT noted that sanctions are an important part of any regulatory system and that, as well as providing a deterrent and helping ensure regulations are complied with, they provide clear guidance as to standards of conduct that must be observed. Some broad principles were followed when developing the proposals for sanctions, these being:

- A sanction should be reasonable and proportionate to the harm or loss caused by the behaviour that it is addressing.

- The CAA should enjoy the maximum amount of flexibility and independence in deciding what action is appropriate to address an infringement of statute/licence conditions. This allows it to take a “sliding scale” approach to enforcement – by imposing a sanction that appropriately matches the harm caused by behaviour and, where appropriate, imposing a less serious sanction at the outset and moving to a more serious sanction if non-compliance continues.
- Sanctions should be clear and transparent as to whom they apply, the behaviour that is subject to the sanction, the approach and process of the regulator in deciding which sanction to impose and how to impose any such sanction, as well as the nature of the sanction and the amount of financial penalty.

- The design of sanctions should be consistent with the Government’s wider regulatory policy as reflected in the Better Regulation agenda, the recommendations contained in the Macrory Review and the provisions of the Regulatory Enforcement and Sanctions Act 2008.

4.78 In the Consultation the DFT noted that it had considered the range of sanctions available to other economic regulators within a licence regime. The water, gas, electricity, rail and National Air Traffic Services (NATS) regimes contain similar provisions for the enforcement by the relevant regulator of non-compliance by the licence holder with the licence conditions. The sanctions available to most regulators comprise the issue of an enforcement order, the imposition of a monetary penalty and/or revocation of the licence.23 The DfT proposed that Enforcement Orders, both provisional and final, are used as the first step towards enforcing licence conditions where there has been a breach such as failure to meet performance standards or failure to pay certain charges.24 It proposed that notice of an order is served on persons likely to be affected by the order and the licence holder. At this stage, persons on whom notice had been served would be required to be given time to make representations and objections in respect of the order.25 Once an order had been made, only the licence holder on whom the order had been imposed would be able to appeal to an appropriate chamber within the First-tier Tribunal of the new Tribunal Service.26 The First-tier Tribunal would have power to quash the order, or any provision of the order, or uphold it. The First-tier Tribunal would not, however, impose its own order.27 The Consultation noted that the ability to quash only part of an order, which would otherwise remain in force, is also a more focused remedy than is available in judicial review proceedings. This process is consistent with the Macrory Review and is similar to other regulated regimes but takes advantage of the creation of the new First-tier Tribunal. The First-tier Tribunal plans to add a ‘General Regulatory’ chamber within the next 2 years that the DfT believes will provide a suitable venue and level of expertise to efficiently handle appeals on sanctions for breach of licence condition.28

23 There are some differences between regulators, for example, the NATS regime does not provide for penalties and the licences of NATS and Network Rail can only be revoked by the Secretary of State.

24 Failure to comply with an enforcement order breaches a duty owed to persons affected by contravention of the order and an affected person can claim damages against the licence holder in relation to the breach.

25 Also, prior to revoking an enforcement order, the parties are typically required to be given at least 28 days to make representations/objections to the revocation.

26 The First-Tier Tribunal is a new generic tribunal established by Parliament under the Tribunals, Courts and Enforcement Act 2007. The First-Tier Tribunal’s main function is to hear appeals against decisions of the Regulator where the tribunal has been given jurisdiction.

27 In the case of the Rail Sector, where the order relates to payment of a sum then the Court may make provision substituting the sum or dates by which the sum should be paid.

28 If the General Regulatory Chamber is not in fact established in the next 2 years, the appeal body should be the High Court which is the current appeal body in relation to licence enforcement in other regulated sectors.
4.79 The Consultation noted that in each of the regulatory regimes which the DfT considered (with the exception of NATS), where the licence holder has contravened any condition, caused contravention by another party or falls below the prescribed standard of performance, the relevant regulator is able to impose a penalty of such amount as the regulator determines subject to a prescribed limit. Generally it is laid out in legislation that the penalty should be of a reasonable amount and that the penalty is payable within 42 days or such longer period as the regulator specifies. Prior to imposing any penalty, the regulator is required to follow a statutory process which includes publishing a notice bringing the matter to the attention of persons likely to be affected by them. The regulator is also separately required to publish a policy statement with respect to the imposition of penalties and the determination of their amount. The licence holder is able to appeal both the timing of payment of the penalty and the imposition and/or amount of the penalty. On the matter of timing, the licence holder is able to appeal first to the regulator and if this does not resolve the matter, the licence holder can then appeal to a First-tier Tribunal. The First-tier Tribunal can quash the penalty, substitute a lesser amount, or offer alternative dates for payment of some or all of the penalty. In the Consultation, the DfT noted that it believes that the mechanisms for the imposition or challenge of a penalty, as summarised above, appear to be applicable and appropriate for the new legislative framework for airport services and the DfT proposed in the Consultation that this process be adopted for the new legislative framework.

4.80 The Consultation raised the issue of what would be an appropriate upper limit for a financial penalty and proposed the figure of 10% of the relevant undertaker’s annual turnover. This is in line with many other economic regulators – in the water, gas, electricity, rail and communications regimes the maximum limit for a financial penalty is set in statute at 10% of the relevant undertaking’s annual turnover although there are some differences in the definition of what the relevant ‘turnover’ is. For rail, it is ‘railway business activities’, for communications it is ‘provision of communications networks/services’, for water it is ‘regulated activities’, and for electricity and gas it is ‘ordinary activities whether or not included within a licence’.

4.81 The Consultation noted that in the regulated regimes considered by the DfT, the licences (with limited exceptions) contain provision for the regulator to revoke a licence in specified circumstances and following particular procedural steps set out in the licence. The grounds for revocation are, commonly:

- Agreement between the parties;
- the non payment of fees or civil penalties;
- insolvency of the licence holder;
- failure to commence supply of services or ceasing to provide the services;
- providing false or misleading statements; and
- failure to comply with an enforcement order or other statutory order.
4.82 Typically the regulator will notify the licence holder of its intention to revoke and the licence holder will have a period within which to satisfy the concern. The DfT noted that revocation of a licence is a sanction of last resort and one which has fundamental commercial consequences for the licence holder and its customers, as well as consumers. The consultation proposed that the new airport services regulatory framework will require revocation provisions within the terms of each licence and that the provisions for revocation should follow closely the provisions in other regulated licences as summarised briefly above.

4.83 The consultation asked stakeholders (question 7.6) whether they agreed with the proposals to put in place similar provisions for sanctions and enforcement by the CAA for the airports sector that apply in the other main regulated sectors in the UK. It asked two more specific questions:

- Would a maximum financial penalty for licence contraventions of 10% of the relevant undertaking’s annual turnover be an appropriate upper boundary?
- Are there any particular features of the airports sector that would justify or require a different approach to licence revocation?

Consultation responses

4.84 The CAA agreed with the DfT’s proposals, and commented on the regime in the airports sector as it presently stands, stating that it lacks the flexibility afforded to other economic regulators. As a result, the CAA’s ability to respond in a proportionate manner to potential non-compliance is limited. The CAA supported a “sliding scale” approach to sanctions and enforcement based on a combination of both criminal and civil penalties, as this would provide the CAA with sufficient flexibility to encourage compliance and to impose penalties that are proportionate to the level of non-compliance. This approach should, in the CAA’s view, be supplemented by clear information gathering powers to enable the CAA to undertake proportionate monitoring and, where appropriate, to undertake enforcement activity. The CAA supported the proposals on financial penalties, suggesting that the CAA could be granted broad discretionary powers to apply financial penalties for non-compliance through civil powers. These powers could be tailored to an estimate of the magnitude of the harm caused and therefore, it is felt, will benefit from greater credibility that they would be applied in practice.

4.85 BA supported the adoption of the principles recommended by the Macrory Review as represented in the Consultation. Although BA supported the use of enforcement orders and revocation of licences, it does not support the use of penalties as, in BA’s view this removes investment from the industry and transfers it to the Treasury which is detrimental for consumers.
BAA supported elements of the principles identified by the DfT that are intended to shape the sanctions regime, but stated that in order for sanctions to be ‘reasonable’ it is important that they are:

- Imposed only where there is clear and identifiable transgression that is attributable wholly and exclusively to the party on whom the sanction is levied;
- proportionate to the detriment arising;
- not likely to cause difficulties for the carrying out of licence obligations;
- appealable;
- levied in a consistent manner;
- supported by the proposed obligation on the regulator to give notice and publish a policy statement on the imposition of penalties and the determination of their amount; and
- consistent with the relevant principles of Better Regulation.

BAA also recognised that a licensee must be accountable for any failure to discharge its duties or comply with its licence conditions, and that it is the responsibility of the licensee to do everything within its power to ensure compliance. Due to this, licence conditions should, in BAA’s view, be drafted so as to reflect those defined outcomes that are within the power of the licensee to control. BAA is also concerned about the CAA having the ‘maximum amount’ of flexibility in deciding what action is appropriate in relation to sanctions. BAA stated that whilst some degree of discretion may be advisable, the boundaries of the CAA’s flexibility should be clearly prescribed. BAA stated that the CAA should be obliged to publish and comply with an Enforcement Policy that reflects the principles of regulatory best practice and includes its intended approach to penalties. The policy should then only be finalised or amended with the consent of the Secretary of State.

The Air Transport Users Council (AUC), the Campaign to Protect Rural England (CPRE), easyJet and Virgin also agreed with and supported the adoption of the principles as proposed by the DfT. Gatwick Airport and Manchester Airports Group (MAG) also supported the introduction of a sanctions regime similar to those that apply in other regulated sectors in the UK. Other respondents have either not commented on the issue of sanctions and enforcement, or have stated that they have no strong view. Belfast and Cardiff International airports, in identical answers, question who the penalty would apply to and also how the target of the penalty relates operationally and legally to the cause of the contravention and the accountabilities within their ambit. They did not, however, make any specific suggestions on how these issues should be addressed.

In terms of the 10% cap for penalties, the CAA supported this, saying that, in order to make it operable, a clear criterion for determining the undertaking’s annual turnover would need to be established. It suggested that this may be best achieved by giving the CAA the power to determine the definition for annual turnover, subject to consultation with stakeholders,
to which the pro rata penalty will be applied. In cases where the CAA is considering revocation of a licence, the framework should make it clear that any financial loss is distinct from the maximum financial penalty.

4.90 On the other hand, BAA and Gatwick, whilst accepting the need for a cap on the financial penalty, were very concerned about the maximum level of this penalty. They accept that the figure has precedents in other regulated sectors, but Gatwick stated that the 10% figure is derived from the most extreme form of abuse under the Competition Act, while BAA stated that there does not seem to be an economic rationale for the 10% limit in this case. Gatwick proposed that, if the DfT decides on a 10% cap, this should be included in primary legislation. However, it would then, in a similar way to BAA, also propose that an initial cap of 5% be mandated as part of secondary legislation. This would give the DfT the flexibility to move towards the maximum cap if this was necessary, but would also give the airport operators, and the regulator, an opportunity to understand how the new regulatory regime was to work in practice. BAA did not propose that DfT move to a higher cap than 5% over time.

4.91 On revocation, the CAA supported the proposal that the CAA has the power to revoke licences, but noted that such a sanction would be reserved only for the most blatant abuses. The CAA believes that the regulatory framework should therefore provide the CAA with alternative – and less severe – sanctions, so as to enable it to adopt responses that are proportionate to the harm caused by the airport’s non-compliance.

4.92 BAA emphasised that it is critical that revocation should only occur for specific, defined and transparent grounds, and that the revocation provisions should apply only in a very limited and tightly defined set of circumstances. BAA’s own proposed grounds for revocation are:

- agreement between the licensee and the CAA to terminate the licence;
- repeated failure to comply with enforcement orders and statutory orders (subject to appeal); and
- non-payment of fees or financial penalties.

4.93 BAA points out that grounds for revocation vary between sectors. Failure to start supply, or the cessation of supply, is a provision that appears in other sectors. This would be problematic in the context of airports, given that supply is sometimes subject to disruption due to external factors that are beyond the control of the airport concerned, and which by their nature cannot be anticipated as to their timing or extent.

4.94 BA agreed that the regulator should be able to revoke the licence but believed that a points based enforcement regime is likely to be much more proportionate and effective, with removal of licences following the build up of too many points for smaller violations. It makes the point that this type of approach has been used extensively in Private Finance Initiatives with numerous examples in roads and hospitals. Gatwick noted that it is not opposed to clear grounds for licence revocation as long as there are ample opportunities to remedy the reasons for a proposed licence revocation. Gatwick also raises a concern, namely that in other sectors,
licences were introduced on privatisation for most privatised companies. As such, it was clear to investors at the time that there would be grounds for revocation. However, as this is being introduced to existing owners in the airports sector, with pre-existing financial structures in place, it is particularly important that the grounds for revocation are clear and that the initial licence term should be long, rolling or perpetual.

4.95 The Competition Commission did not comment on sanctions in detail. It did, however, comment that it would expect the regulator to be given statutory powers to impose financial penalties and to be able to serve orders requiring compliance in future.

Government’s decision

4.96 There is broad agreement that sanctions are an important part of the regulatory regime and that sanctions should:

- Be reasonable and proportionate;
- provide the regulator with appropriate flexibility;
- be clear and transparent and consistent with wider regulatory policy; and
- broadly follow the regimes applicable in other regulated sectors.

4.97 No respondent disagreed with the principle of a sanctions and enforcement regime similar to that applicable in other regulated sectors and such a regime has broad support. We anticipate that the details of the regime as developed will reflect these principles. BAA’s concerns expressed above are noted and will be considered further as the precise licence terms are developed.

We agree that, in common with other regulators, the CAA should have to publish and adhere to an enforcement policy and for the CAA to be obliged to exercise its powers in accordance with the Macrory principles.

There was no comment against the proposal that enforcement orders should be part of the enforcement regime and the regime will reflect this.

4.98 Only one respondent did not support the use of penalties as a sanction. That respondent was concerned that penalties remove investment from the industry to the detriment of consumers. We note that this point could also be argued in relation to all other regulated sectors where the right to impose financial penalties exists. In our view this issue relates to and can be addressed through the requirement for the CAA to operate an enforcement policy and for the level of financial penalty to be reasonable, and subject to appeal. The fact that the CAA will be carrying out its function in line with the primary duty to passengers will also, in our view, adequately address this concern.

29 Many of the sanctions will also give effect to European obligations and, consistently with wider regulatory policy and European law, the regime will be proportionate, dissuasive and effective.
The consultation responses have addressed two issues concerning the calculation of penalties – whether the proposed 10% limit on the amount of any financial penalty is the right level, and on what turnover the limit should be based. The two issues are interrelated. The purpose of the limit is to place a statutory control on the ability of the regulator to levy a financial penalty whilst leaving the regulator sufficient flexibility to impose a meaningful but reasonable sanction in any particular circumstances that may arise.

The 10% limit is common across other sectors and also applies in relation to competition law infringements at UK and EU level. We have considered in the light of responses whether there is any justification for not adopting that level in the airports sector. The argument put forward by BAA and Gatwick is that a 10% level would expose the regulated company to an unnecessary level of risk in a regime which is so far untested, and that the 10% lacks any economic rationale. We believe that the practice in other sectors and in the competition law regime is that the level of penalties has commonly been significantly below the 10% cap and no evidence has been made available to us to suggest that the cap has encouraged regulators to impose penalties higher than would otherwise be the case. Indeed, the limit has in practice been applied to reduce the level of penalty otherwise payable. Further, the enforcement policy of other regulators has not generally used the limit as a basis for penalty calculation – turnover in the relevant affected market is the usual starting point. The issue therefore is whether, in a particular case where otherwise a penalty would be justified as reasonable at a higher level, a 10% penalty (as opposed to a lower level) should be the limit of an infringing company’s exposure. Having taken all of these factors into account, we have decided that a 10% limit is an appropriate upper limit and should be used in the airports regime.

In relation to the turnover definition, the purpose of the cap is to constrain the power and discretion of the regulator and to provide some certainty as to the financial consequences of infringement whilst leaving the regulator with sufficient power and flexibility to levy financial penalties which discourage infringement and penalise infringing behaviour. The turnover definition adopted can have a material effect on the actual level of cap in specific circumstances. For example, take a company where regulated activity is a relatively small part of the group undertaking’s overall activity. A cap which is calculated by reference to the group’s overall turnover could result in a cap which has no direct relevance to the turnover of the regulated business. In contrast, a cap calculated by reference to the turnover of the regulated business will result in a cap which may have little or much reduced deterrent effect on the group. Reference to other sectors does not directly assist resolving the issue. Rail, telecoms and water define the cap by reference to the regulated turnover; in contrast gas and electricity define it by reference to regulated and non-regulated turnover. Competition law also defines it by reference to the wider test although reliance on this comparison is perhaps of less value as there may be a valid distinction to be drawn between sanctioning a licence breach and sanctioning unlawful antitrust behaviour.
4.102 The issue can be approached in an alternative way. To what extent do we believe that a reasonable and proportionate penalty to be imposed by the CAA would be at a level higher than a cap calculated by reference to the turnover of the regulated business? In those circumstances, will the existence of the cap fail to deter infringing behaviour? It is to be noted that the monetary value of the cap is likely to be high – the regulated turnover is likely to be significant and will therefore have some form of deterrent effect. The deterrence in such circumstances will also be affected by the existence of other sanctions and also the reality of the regulated company’s continuing relationship with the regulator and the public perception of the company in that event.

4.103 Our view is that on balance, a cap based upon turnover related to the regulated airport should be capable of maintaining a sufficient and serious deterrent effect on regulated companies and will enable the CAA to impose reasonable and proportionate financial penalties for licence infringement. The cap will be in most cases a significant number in monetary terms. We would also note that the adoption of the narrower turnover definition will balance any adoption of a 10% level and therefore address some of the concerns expressed by BAA and Gatwick.

4.104 We also considered whether the cap should be provided for in primary legislation or be capable of amendment either through secondary legislation at the direction of the Secretary of State or by giving appropriate discretion to the regulator. The purpose of the cap is in part to constrain the discretion of the regulator. It therefore appears inappropriate to enable the CAA to be able to amend the cap. In other sectors, the percentage is specified in primary legislation with the Secretary of State determining the precise turnover definition through secondary legislation. This seems to be the most appropriate mechanism to be adopted in relation to the new airports regime. It would address some of the concerns raised that the cap may be too high and provide a mechanism for the cap to be adjusted if appropriate in the light of experience.

4.105 No respondent objected to the proposals for the licence holder to be able to appeal against the imposition of an enforcement order or the imposition of a penalty to the First-Tier Tribunal as set out in the Consultation and the Government has decided to proceed with these proposals. This would be subject to discussion and agreement with the Tribunals Service that the First-Tier Tribunal is a suitable appellate body for these matters.

4.106 There was broad agreement on the revocation grounds proposed in the consultation. BAA suggested those grounds should be more limited. On balance we believe the grounds proposed in the consultation provide an appropriate basis for the development of the detailed licences though we accept that as that detail develops some of the proposed grounds of revocation may become unnecessary. The Section 16 request to the CAA for advice on the provisions of the new licences includes a request to consider further the most appropriate provisions for revocation taking account of the DfT’s current views.

30 The precise definition will be determined in consultation with the CAA and other stakeholders and implemented, possibly through secondary legislation, at a later stage.
In our view, BAA’s suggestion that the grounds for revocation should be limited as it has suggested is not justified. In appropriate circumstances, a licence holder’s failure to pay fees, or its insolvency, or its provision of misleading statements, or its failure to provide services, may result in revocation being an appropriate regulatory response and the justification for denying the regulator these tools does not appear strong. We do accept that the precise grounds for revocation will continue to evolve as the detailed licence terms are developed and, for example, it may be that non payment of fees is penalised through enforcement orders (with revocation then a possibility through that ground). However, at present we remain of the view that the following grounds of revocation as outlined in the consultation form the correct basis to continue the development of the licence terms:

- Agreement between the licence holder and the regulator;
- the non payment of fees or civil penalties;
- insolvency of the licence holder;
- failure to commence supply of services or ceasing to provide the services;
- providing false or misleading statements; and
- failure to comply with an enforcement order or other statutory order.

It will of course be necessary to provide information gathering powers similar in scope and with similar constraints as to disclosure to those presently available to the CAA for the discharge of its airport economic regulatory functions. We expect this will be added either directly in legislation or through the granting of powers to the Secretary of State by Statutory Instrument to make requisite rules. It is also possible that licence conditions may contain obligations on the provision of information to the regulator.

**Concurrent competition powers**

**Government’s proposal**

The consultation document noted that there are a number of benefits associated with concurrent competition law powers including that:

- The regulator has detailed knowledge of the sector and may be best placed to understand complaints being made;
- sectoral regulators are likely to be better placed to identify competition concerns in the market even in the absence of specific complaints; and

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31 If we propose that further circumstances should allow for revocation we would consult on the principle as well as the possible drafting of the licence condition(s).
33 Concurrent powers in this paper refers to the powers to apply competition law in particular sectors, exercisable by either the relevant sectoral regulator or the OFT. Concurrent powers are powers to make market investigation references under s131 EA02, powers to investigate infringement of the Chapter I and Chapter II prohibitions in the CA98 and Articles 81 and 82 of the EC Treaty in the UK.
4. Designing a flexible, fair and effective enforcement regime

- regulators with concurrent powers will be able to judge whether an issue is more appropriately regulated through sector specific regulation or the use of general competition powers.

4.110 Questions relating to potentially anti-competitive behaviour by airports are currently subject to potential scrutiny by two separate authorities: the CAA under section 41(2) and (3) of the Airports Act 1986 and the OFT under the Competition Act 1998 (“the CA98”) and, where the activities in question may have an effect on trade between EU Member States, by the OFT under Articles 81 and 82 EC Treaty. The consultation document also noted that in February 2001, the CAA acquired concurrent powers under Chapter V of the Transport Act 2000 to enforce provisions of the Competition Act 1998 and the EC Treaty. The CAA also acquired limited powers to make Market Investigation References (MIR) to the Competition Commission under the Enterprise Act 2002. These powers did not apply to airport services but only to the supply of air traffic services.

4.111 As a consequence, we consulted on the proposal to give concurrent powers relating to airport services to the CAA. The following question was put to stakeholders (Question 7.7):

- Do you agree that the CAA should have concurrent competition law powers for airport services in the UK?

Consultation responses

4.112 There was widespread support for the CAA being granted concurrent competition law powers in relation to airport services. The Air Transport Users Council noted that the CAA had expertise in the sector and extending its powers would enhance its role in protecting passenger interests.

4.113 Airports and airlines were broadly in favour of giving the CAA concurrent competition powers. However, Gatwick Airport suggested that two criteria needed to be met before lending their support to the proposal. First, the CAA should be reformed in line with the Pilling Review and second, the CAA should issue guidance regarding the interpretation of competition powers and agree suitable application of powers with the OFT. The OFT also noted that the definition of “airport services” for the purposes of concurrency needed to be carefully considered.

4.114 Some responses were not so supportive of the CAA having concurrent competition powers. Some organisations (notably Stop Stansted Expansion and Which?) thought that too many powers should not reside with one organisation and the clear separation of powers between the CAA, OFT and the Competition Commission should be maintained.

Government’s decision

4.115 We believe that the CAA should have concurrent powers for services provided by airport operators. The OFT has no objection to this and notes that extending to the CAA concurrent competition powers over airport operators is consistent with competition law concurrency as it currently applies in other UK regulated sectors. In this vein, having concurrent competition law powers over airport operators would
mean, among other things, that the CAA was able to judge whether conduct can be better assessed under sector-specific airport regulation or general competition powers, such as the CA98 and/or Articles 81 and 82 EC Treaty. The CAA could therefore co-ordinate its use of sector-specific regulation over airport operators as well as its technical expertise with the exercise of general competition powers. This would also allow the CAA and OFT to co-ordinate and agree under the Concurrency Regulations (SI 2004/1077) which of them is better placed to act on specific competition law cases involving airport operators.

4.116 We are separately consulting on a proposal to give the CAA additional concurrent powers, which would cover services provided at the airport by parties other than the airport operator. For more information on this proposal see “Regulating Air Transport: Consultation on proposals to update the regulatory framework for aviation”.

Statutory undertakers

4.117 Under the 1986 Airports Act any airport that holds a permission to levy airport charges is deemed to be a statutory undertaker. A consequence of moving to a more flexible licence based regime is that airports will lose their status as statutory undertakers. We understand that currently around 55 airports hold such permissions based on their meeting the turnover threshold – £1million per ‘financial year’ in at least two of the last three ‘financial years’ – of the Act. Consequently, such airports have rights and obligations as statutory undertakers for enactments listed in Schedule 2 of the 1986 Act as well as under various additional pieces of legislation including (but not limited to):

- rights to carry out, without planning consent, certain developments at the airport, which include the erection of operational buildings or small sized terminal buildings or terminal extensions under the General Permitted Development Order (GPDO) 1995;
- the right to be consulted on National Policy Statements under the Planning Act 2008 relevant to their functions; and
- an obligation to prepare, at the request of the Secretary of State, reports on the airport’s policies for adapting to climate change under the Climate Change Act 2008.

4.118 A full list of the rights and obligations conferred to an airport operator as a statutory undertaker is included in Annex 3.

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34 http://www.dft.gov.uk/consultations/open/regulatingairtransport
35 Separate arrangements exist in Northern Ireland for deeming airports as statutory undertakers.
36 An airport has statutory undertaker status if it has or has a subsisting pending application for a permission to levy charges under Part IV of the Airports Act 1996 AND it is not for these purposes an excluded airport under section 57(2) of that Act.
37 The Secretary of State has power by order to increase this sum.
38 Part 5 of the 1986 Airports Act gives effect to Schedule 2.
4.119 During the public consultation some smaller airports raised concerns that losing their status as statutory undertaker (particularly the rights conferred to them under the GPDO) would have significant consequences for their business. In light of this, they urged the DfT to ensure that the reformed regulatory regime includes a mechanism for preserving these rights. According to the CAA, many of the smaller airports with permission to levy charges have exercised their statutory undertaker rights and it has been claimed by at least one airport that being able to erect revenue-generating buildings easily without having to go through a planning process can be the difference between a profitable and a loss-making business.

4.120 It was not our intention to remove an airport’s statutory undertaker rights – this has arisen as an unintended consequence of moving to a more flexible, licence based regime. The fact that airports have certain rights and obligations conferred upon them as statutory undertakers is not relevant to the economic regulation of airports and as such we are not, in principle, minded to disturb these rights and obligations. In any event, having looked at the individual rights and obligations conferred upon airports as statutory undertakers, we have no reason to believe, or evidence to suggest that these are inappropriate. Against this background, the only issue is how to preserve this status under the new regulatory regime.

4.121 Currently, in order to decide whether or not to grant an application for permission to levy airport charges (and therefore deem the airport operator as a statutory undertaker) the CAA must be satisfied that the applicant is subject to economic regulation under part 4 of the 1986 Act. This means the CAA must also be satisfied that the applicant has met the requisite threshold (i.e. ‘annual turnover’ of the relevant business exceeds £1million per ‘financial year’ for two of the last three ‘financial years’).

4.122 Where the Secretary of State is satisfied that the annual turnover of an airport did not exceed £1million per ‘financial year’ for each of the past two ‘financial years’, he may, after consulting with the CAA, determine that the airport shall cease to be subject to economic regulation. One consequence of this is that the airport will no longer be deemed to be a statutory undertaker.

4.123 In order to maintain the status quo under the new regulatory regime we have therefore decided to

- Provide the CAA with a standalone function to determine, upon receipt of an application, if the airport operator meets or exceeds the required threshold. If they were satisfied that the required threshold had been met, the airport would be deemed to be a statutory undertaker provided it is not owned by a principal council or by a metropolitan country transport authority or jointly owned by two or more principal councils or by such an authority and one or more such councils.
- If, and whenever the Secretary of State is satisfied that an airport no longer meets the relevant threshold for each of the past two financial years, he should be empowered, after consulting the CAA, to decide whether the airport will cease to be deemed as a statutory undertaker. In reaching these decisions, we expect that the Secretary of State would obtain appropriate advice and assistance from the CAA.
We also think it would be preferable to put in place measures that would see all airports currently deemed as statutory undertakers retaining this status (but subject to the provisions under which all airports may lose that status). This will avoid unnecessary work at the implementation of the new regime when all airports currently holding permissions would have to apply to retain them.

Summary of key decisions

This Chapter sets out our proposals to ensure that the CAA has a flexible, fair and effective enforcement mechanism for its future economic regulation of airports that is focused on furthering the interests of passengers. The main elements of our proposals are to:

- Introduce a two tier licensing structure. Airports in Tier 1 will be those with substantial market power where regulatory intervention is warranted, while those in Tier 2 will be other airports meeting the 5 million passenger a year threshold in the ACD. Currently apart from provisions necessary to ensure that the licence is effective, such as a revocation condition, the DfT is anticipating that the Tier 2 licences will only include any provisions not directly related to the ACD and the functions of Passenger Focus.

- Introduce primary legislation based on the current designation/de-designation criteria to determine whether an airport should have a Tier 1 licence. The appeal mechanism for the CAA's decision about whether an airport should have a Tier 1 licence is discussed in Chapter 6.

- Seek advice under Section 16 of the Civil Aviation Act 1982 from the CAA regarding the drafting of some licence conditions. This advice will be taken into account by the Secretary of State in formulating draft licence conditions to be published for consultation; the Secretary of State would be responsible for deciding upon the precise content of and issuing the initial licences.

- Give the CAA similar sanctions and enforcement powers for breach of licence to the powers held by other economic regulators in the UK. This includes the use of enforcement orders to ensure compliance with licence conditions. The CAA will be required to develop a published enforcement policy.

- Give the CAA powers to impose financial penalties for the breach of licence conditions up to a maximum of 10% of the annual turnover of the regulated business.

- Give the CAA concurrent competition law enforcement powers for services provided by airport operators. We are separately consulting on giving the CAA additional concurrent powers, which would cover services provided at the airport by parties other than the airport operator.

- Introduce provisions which enable airports to retain their status as statutory undertakers.
5. Promoting financial resilience

Introduction

5.1 In its consultation published in March this year, the Government proposed measures to strengthen the financial resilience of Tier 1 airports and that seek to ensure the continuation of operations in the event of financial distress of airport operators. These included proposals for a new supplementary duty on the CAA to ensure that airports can finance their licensed activities, proposals for a licence condition to introduce financial ring fencing, proposals for a credit rating test, and proposals for a Special Administration regime, which would also help to protect passengers in the event that an airport faces financial failure.

5.2 We recognised in the consultation that measures proposed in this context may have an impact on airports’ existing financing arrangements. However, we were keen to consult with stakeholders to understand the full costs and benefits, and how those measures might be designed and implemented to provide the best outcome for passengers. We concluded in the consultation that it might be appropriate to introduce limited parts of the proposals should full introduction prove not to be in passengers’ interests.

5.3 Following careful consideration of the consultation responses, the Government announced on the 13 October 2009 in a Written Ministerial Statement (see Box 5.1) the outcome of its deliberations on the financial resilience package. The Government announced that it would introduce as soon as parliamentary time would allow, a new supplementary financing duty on the CAA, licence conditions to introduce financial ring fencing with derogations for certain elements, a new licence condition requiring maintenance of a minimum credit worthiness, and that it would not be proceeding with proposals for a Special Administration regime. Two further consultations were announced, which are published alongside this decision document. These propose:

- The introduction of a licence condition requiring airport operators to produce and maintain a Continuity of Service plan, intended to minimise disruption to the business from a transition of control to an insolvency practitioner; and

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39 When we discuss financial ring fencing in this section we mean a suite of provisions that ensure that the regulated business has the necessary resources to provide the appropriate range of services, and is not limited to provisions that restrict the circumstances in which cash can be taken out of the regulated business.
• A requirement for the regulator to meet additional conditions to ‘switch on’ elements of the ring fence that will have been granted derogations upon the introduction of the licence.

5.4 All the above decisions and consultation proposals will apply to or have relevance to Tier 1 airports only. Any detailed implementation or enforcement of the decisions and consultation proposals will be a matter for the regulator.

5.5 In the remaining sections of this chapter we set out the rationale for the Government’s decisions to introduce:

• A new financing duty that will sit as a supplementary duty;
• a package of licence conditions to introduce financial ring-fencing; and
• a licence condition to maintain a minimum credit worthiness.

We also set out our rationale not to pursue Special Administration.

Box 5.1 – Government announcement on the 13 October on the financial resilience package in a Written Ministerial Statement

In March this year, the Government published its consultation on reforming the economic regulation of airports. This contained a package of proposals to strengthen the financial resilience of major airports, support investment and ensure the continuation of operations in the event of financial difficulties for airport operators.

These are challenging and uncertain times for the aviation sector. Following representations, I am bringing forward announcements on the financial elements of the Review to help provide as much certainty as possible for both the industry and its investors. We will be responding to the other elements of the consultation later this year.

To this end, I can announce that the Government will introduce, as soon as Parliamentary time will allow:

• A new duty on the Civil Aviation Authority (CAA) to ensure that airports can finance their licensed activities. This will sit as a supplementary duty to a primary duty to promote the interests of existing and future passengers.
• A package of licence conditions to introduce financial ring-fencing. Following careful analysis of the evidence, the Government has concluded that the costs of introducing certain elements of the ring fence would exceed the benefits. There will therefore be derogations for those elements of the ring fence which would cut across existing financing arrangements.
• A licence condition requiring airport operators to maintain a minimum creditworthiness.
Adequate protection for consumers is our priority. So I can also announce that we will consult further before the end of year on the following additional measures which will further improve the resilience of major airports:

- The possible introduction of a licence condition requiring airport operators to produce and maintain a Continuity of Service plan, setting out how the airport could continue to serve passengers through an insolvency procedure, thus further reducing the risk of airport closure.

- A mechanism for the regulator (CAA) to ‘switch on’ and ‘switch off’ ring-fencing provisions. The regulator might decide to switch on ring fencing if circumstances were to change and where the benefits outweigh the costs, for example because an operator had moved from a secured to an unsecured financing structure.

These measures replace the introduction of a Special Administration regime proposed in the consultation document which I have decided not to proceed with. The March consultation was clear that these proposals would only be taken forward if it could be shown that the costs of introducing such a scheme were not excessive. Following careful analysis of the consultation evidence, the Government has concluded that the implementation costs of introducing Special Administration would outweigh the benefits, and could significantly restrict airport operators’ ability to commit to ongoing investment in the airport infrastructure, adversely affecting passengers. Given this and the relatively low risk of airport closure upon insolvency, we have concluded that the measures above better serve the interests of passengers.

This announcement today supports the sustained investment by airport operators and protects the interest of passengers. We will publish our response to the remaining elements of the March consultation later this year including a summary of consultation responses and a full impact assessment. At the same time we will begin our consultation on the possible additional measures that I have outlined above.

**Financing Duty**

**Government’s proposal**

5.6 The Government proposed to supplement the primary duty with five supplementary duties (see Chapter 3). We proposed that one of those supplementary duties should be a financing duty that would ensure that licence holders are able to finance the activities which are subject to licence obligations.
5.7 The Government asked the following questions in its consultation:

- Given the proposed primary duty to promote the interests of consumers, is a further financing duty required?
- What is the appropriate interpretation of a financing duty in the airports sector?

Consultation responses

5.8 Airports were largely supportive of the financing duty, however airlines were not. Some felt the duty was a crucial complement to other duties. One respondent stated that the financing duty should be on a par with the primary duty. Others stated that the financing duty would be an essential complement to the imposition of obligations or to licence conditions such as a requirement to maintain a minimum investment grade credit rating, or that the financing duty could not be imputed from the primary duty alone.

5.9 Others noted that such a duty is common practice in most other regulated sectors and therefore there seemed no reason why there should not be a similar duty for the aviation sector. However, some respondents suggested that the financing duty was unnecessary, because it was implicit in the primary duty. Further responses suggested that it was not relevant because it would apply to only three airports.

5.10 The question regarding the “appropriate interpretation” of the financing duty in the airports sector was often not directly addressed. Respondents generally focused on how they felt the duty would be interpreted rather than what was most appropriate.

5.11 A small number of respondents highlighted specific interpretations of the financing duty that they felt would be positive. One respondent emphasised that it should ensure that an efficient operator is able to finance its regulated activities. Some other respondents emphasised that it should support the raising of finance for capital projects, also noting that it should permit operators to earn an economic return. Additionally, they felt that it should support investment in safety and environmental measures, and one respondent felt that it should support job security. Another respondent reflected the view that the financing duty should be interpreted as an obligation for the licence holder to be able to finance its obligated activities.

5.12 Many respondents emphasised a desire for more clarity over the interpretation of the financing duty, in particular stating that it was not clear how such a duty would be interpreted by future regulators. Some respondents were critical of the financing duty suggesting that it was vulnerable to misinterpretation in its current form, for example it could blur the division of responsibility for maintaining an appropriate financial structure.

5.13 Other respondents felt that the financing duty would not support consumers’ interests because such a duty would result in inefficient or unreasonable financing costs being passed on to consumers. This could lead to customers effectively funding inflated bids for airports, resulting in an inappropriate sharing of business and financing risk between consumers and airport operators. More specifically, one respondent argued that funding decisions are the operators’ alone, and therefore that it should be clear that
one-off adjustment costs should fall on airports not consumers. As such a financing duty could create an environment where the operator attempts to use the financing duty to acquire a better regulatory determination.

**Government’s decision**

5.14 Following careful consideration of the consultation responses, the Government announced in the Written Ministerial Statement that a financing duty should be introduced as a supplementary duty to the primary duty. Whilst it can be argued that there is no need for an explicit financing duty because it is implicit within the economic regulator’s proposed primary duty, we remain of the view that the existence of such a duty is important to provide reassurance to investors. We also remain of the view that the financing duty provides investors with confidence that whilst the regulator will seek to promote the interests of consumers by ensuring airport operators provide airport services they demand at least cost, this will not be regardless of an economic and efficient company’s ability to finance itself.

5.15 We recognise that although the CAA currently has no financing duty, it does have a policy to ensure, when setting price caps on a RAB basis, that a notional, efficient airport operator can finance its operations and investment. We believe that the financing duty will be consistent with the CAA’s new primary duty to passengers and that the supplementary duty will make this explicit.

5.16 We are not of the view that the financing duty is unnecessary because it will currently have relevance to only three airports (Gatwick, Heathrow and Stansted). From current evidence those airports are likely to be allocated a Tier 1 licence because they hold substantial market power. Such airports will need to be regulated according to their market position, and evidence from other regulated sectors suggests that intervention by the regulator needs to be enhanced by a financing duty.

5.17 On the question of interpretation, in response to the Written Ministerial Statement on the 13th October, the CAA’s provisional view is that the duty would require the CAA to encourage efficient and economic investment by allowing reasonable returns over time. However, it would not require the CAA to ensure the financing of regulated airports in all circumstances. For example, the CAA does not expect the financing duty to require the regulator to adjust regulation, price, service and investment to take account of an airport’s particular financial arrangements.

5.18 In response to the alternative interpretations suggested, we have not been presented with evidence that changes our view about the interpretation of the financing duty; namely that it should ensure that an efficient operator could finance its licensed activities. This means that we expect the regulator to base its regulatory settlements on the revenues that a notional company would require to finance its functions, which will involve setting the cost of capital assuming a notional capital structure and then, based on projections, ensuring that the company could be reasonably expected to meet its required ratios (implied by a licence condition to retain a certain credit worthiness) throughout the control period.

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40 http://www.caa.co.uk/application.aspx?catid=14&pagetype=65&appid=7&newstype=n&mode=list&year=2009&quarter=3
5.19 It is not the Government’s intention that the duty should be interpreted in a way that puts passengers at risk by making them pay for an inefficient operator’s financing decisions. Rather, it is the Government’s view that the duty should be interpreted as applying to an efficient operator, and that the regulator will be under no obligation to ‘bail out’ an operator which faces financial difficulties. Legislation will be drafted with this intended interpretation in mind. We believe that the financial package as a whole incentivises the operator to improve financial resilience, for example by injecting more equity or risking regulatory enforcement action. The Government believes that the presence of the primary duty that promotes the interests of passengers, and a further supplementary duty that ensures that all reasonable demands for airport services are met efficiently will help protect passengers from such risks.

5.20 In order to address uncertainty about interpretation of the duty, we would expect the regulator to issue guidance that clarifies how it intends to give effect to the duty and to update this guidance when it believes it to be appropriate. The Government will also consider issuing statutory guidance for the regulator to take into account when it considers how it intends to apply the duty if the Government thinks that this would be appropriate and that it would not undermine the independence of the regulator. However, the Government is of the view that the financing duty should be worded in legislation to allow some flexibility for the regulator to make discretionary decisions based on market conditions. We expect the regulator to follow best practice when providing an explanation in its guidance of how it intends to discharge its duties.

Minimum Credit Worthiness

Government Proposal

5.21 We stated in the consultation that, in principle, a minimum credit rating provision is a useful way for the regulator to monitor the financial and overall performance of the regulated airport and reassure itself that the operator is financially healthy. We recognised, however, that there are several possible ways in which to introduce this provision, stating that it was common for operators in other regulated sectors to be subject to a requirement to maintain a minimum credit rating.

5.22 The Government asked the following questions:

- Should the regulatory regime be reformed to allow the regulator to introduce licence conditions obliging regulated businesses to maintain an investment-grade credit rating and if so in what form?
- How might such provisions be introduced to minimise disturbance to existing financing arrangements?

Consultation responses

5.23 Respondents to the consultation were, on the whole, supportive of the proposal to introduce a requirement to maintain a minimum credit rating.
Some concern was expressed at placing such reliance on credit ratings established by third party agencies, with the suggestion made that the regulator could instead embed a series of explicit credit and liquidity ratios in the licence. Some consultees argued that if the introduction of such a licence obligation to secure a particular credit rating is set too high or applied to the wrong entity, this could necessitate a complete refinancing. Others felt that the investment grade rating was only superficially attractive because while it would discourage excessive gearing it would not necessarily encourage equity investment. There was apprehension about any measure which could, on its announcement, cause a Material Adverse Effect under current financing arrangements. A further concern was that a minimum credit rating requirement was based on a desire to control financial structures, which could create confusion about whether responsibility for financial failure lies with the operator or the regulator.

Government’s decision

5.24 The Government announced (on the 13th October) that it would introduce a minimum credit worthiness requirement. This is a broader requirement which can take the form of a credit rating approach or a financial ratio approach.

5.25 While we recognise the arguments put forward in favour of embedding credit and liquidity ratios in the licence, we remain at present of the view that a minimum credit rating requirement as adopted in other regulated regimes has substantial benefits. Including ratio requirements in the licence necessitates the regulator to have a detailed understanding of what ratio level represents suitable financial health, and then ensuring that this keeps pace with market conditions over time. This may be an unwieldy process and risks the ratios becoming out of step with market conditions. Instead, the regulator could take the financial ratios out of the licence to enable them to be monitored on a continuing basis but in doing so, the regulator loses the flexibility of a licence condition. For these reasons, it is presently our view that whilst a minimum credit rating is not the perfect solution, it provides a flexible solution to accommodate changing market conditions.

5.26 The Government does not agree that the financial licence conditions are based on a desire to control financial structures. Rather they simply seek to ensure continuing financial stability. How the operator meets this requirement is up to the individual company. For example a defined credit rating does not specify the type of financial structure required to achieve that rating.

5.27 For these reasons, we presently believe that a minimum credit rating requirement drafted in a similar manner to that in other regulated sectors is the best way to achieve our objectives. Credit ratings are used widely by investors when making investment decisions and can encourage investment. We are, however, aware of the existence of some practical issues relating to who holds the licence, on whom the credit rating requirement is placed, how it is defined (for example an issuer rating or a senior debt rating) and at what level the appropriate minimum credit rating requirement will be set. We will be working with the regulator and
stakeholders including licensees on the exact drafting of licence conditions to ensure that they meet our objectives. These objectives include ensuring the costs of introducing those licence conditions do not exceed the benefits, as they would do if compliance with the proposed condition would require lender consent, lead to a covenant breach or precipitate a trigger event.

Ring fencing

**Government’s proposal**

5.28 In the consultation, the Government stated that its provisional view was that ring fencing licence conditions could play a useful role, for example, in providing protection from certain events that may otherwise lead to the insolvency of the licensee and possible disruption to consumers. As shown in other regulated sectors they can also contribute to allowing a licensee to retain access to financial markets on reasonable terms, thus facilitating the funding of future investment. We stated in the consultation document that we understood that there could be implementation issues in introducing such measures in full.

5.29 The Government asked the following questions:

- Should the regulatory regime be reformed to allow the regulator to introduce licence conditions to ring-fence regulated assets?
- How might such provisions be introduced to minimise disturbance to existing financing arrangements?

**Consultation responses**

5.30 There was widespread support for the principle of ring fencing with only a few objections. Some respondents, however, were not convinced of the value ring fencing would offer; concern was expressed that current financing agreements contain provisions, particularly in regard to the granting of security over the assets, that are incompatible with the introduction of a full ring fencing package. The rating agencies also issued a warning that should a full ring fencing package be proposed this could lead to a rating downgrade of current Tier 1 airport debt due to the uncertainty as to whether the required consent of lenders would be given. If consent was not given by lenders, there would be an event of default and it is possible that the airports would have to refinance all their debt. Without security over the assets the creditors would, in the opinion of creditors and the rating agencies, be in a significantly inferior position. As a result, some consultees stated that if ring fencing were to be introduced, it should be introduced in a way that did not require removal of lenders’ security.
5.31 Reforming the regulatory regime to allow the regulator to introduce licence conditions to ring fence the regulated assets was announced in a Written Ministerial Statement in October 2009 (see Box 5.2). Evidence from the consultation suggests that transitional arrangements are, as we suspected in the consultation, necessary in order to minimise disturbance to existing financing arrangements. The costs entailed without such transitional arrangements would disrupt ongoing investment in core infrastructure assets and would thus be detrimental to passengers. As many of the controls which would be included in the full ring fence are present in the current financing arrangements, the benefits are likely to be minimal. We are therefore of the view that they are outweighed by the costs. The Government has issued a consultation on these proposed transitional arrangements alongside this decision letter.

5.32 The Government has decided that a full set of ring fencing provisions will exist in a Tier 1 airport operator’s initial licence and that there will be derogations for the elements of the ring fence where the benefits of a ring fence condition would be outweighed by the costs e.g. that would require lender consent, lead to a covenant breach or precipitate a trigger event. This is due to the fact that amending existing financing arrangements would result in significant costs for the following reasons:

- Lenders to the airport industry currently value security highly and existing financial arrangements rely on the continuity of this arrangement. Should a change be required from this position, consent would be required from lenders. This consent would not necessarily be given. Should consent not be given a complete refinancing would be necessary which, if possible at all, is likely to be extremely expensive; and,

- Rating agencies have expressed concern about the impact on existing financings of removing security. Following the March consultation Standard & Poor’s issued a statement (28 September) saying that there is a risk of a ‘multi notch downgrade’ resulting from the uncertainty over debt repayments that changes to the security aspects of existing financing arrangement would create.

5.33 These costs could result in significant delay to investment in much needed infrastructure, which in turn would be detrimental to passengers. Additionally, the current financing agreements contain many of the controls which would be included in the ring fencing licence conditions. Thus in so far as creditors’ interests are aligned with passengers’, replication in licence conditions is arguably unnecessary.

5.34 We are consulting on a mechanism to enable ring fencing provisions to be ‘switched on’ in future, when there has been a material change of circumstance and when the benefits of doing so exceed the costs.
Box 5.2 – Possible Initial derogations

Typical ring fencing conditions found in other regulated sectors are as follows:

a. A requirement to maintain a minimum credit worthiness, for example by maintaining a minimum credit rating;

b. A requirement for the licensee’s directors to confirm adequate resources to carry out the licensed activities;

c. Restrictions on the activities a licensee is allowed to carry out;

d. A requirement that the licensee does not incur indebtedness nor guarantee any liability of another person other than on specified terms and for a permitted purpose;

e. An undertaking from the ultimate controller of the licensee that it will not take action which may cause a breach of licence;

f. A prohibition on the granting of security over assets of the regulated business;

g. Prevention of the offering of cross guarantees; and,

h. Restrictions on disposals of the regulated assets.

This list is not exhaustive.

Initial derogations would be required to a greater or lesser degree in the case of most of the conditions we propose to introduce. However, details will depend on the financing arrangements of operators at the time that the first licences are introduced. Most important are those relating to the granting of security as found in the indebtedness condition.

Examples of derogations which could be required are:

**Disposal of relevant assets**

As this could restrict creditors’/administrative receiver’s rights to sell/dispose of assets post enforcement of security, i.e. a constraint on enforcement of existing security, derogation could be required where secured lending currently exists. However, if there was a debt financing of the assets with less restrictive covenants, then some restriction could be imposed to prevent piecemeal disposals.

**Availability of resources**

Some caveats may be required in the confirmation from the licensee’s directors that there are sufficient resources to carry out the licensed activities given that in a secured financing structure the creditors have been granted security over the assets.
**Restriction on activity and cross guarantees**

Cross default arrangements may need to be the subject of derogations together with existing contractual arrangements which oblige the licensee to carry out activities which would not be otherwise permitted under this provision.

**Indebtedness and pledging assets as security**

This is the licence condition which deals with security. It provides that no indebtedness or security be incurred except on specified terms and for a permitted purpose. We would therefore expect this to be the subject of derogations for an operator with a secured financing structure.

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**Special Administration**

**Consultation proposal**

5.35 In the consultation, the Government proposed the introduction of a Special Administration regime provided that implementation costs were not excessive. The consultation stated that the main purpose of a Special Administration regime would be to ensure that where the continued operation of an airport is important for the effective operation of the UK transport system and therefore the UK economy, there is a provision to ensure that the airport will continue to operate in the event of financial distress.

5.36 The Government asked the following questions (Question 9.6):

- Should the DfT introduce a Special Administration regime for the airports industry?

- Are airports sufficiently important assets for the Government to take steps to ensure their continued operation? If the Government were to introduce Special Administration for airports how should this be designed and implemented? Do you believe that a staged implementation of the Special Administration regime over a period of time would be helpful?

- How might such provisions be introduced to minimise disturbance to existing financing arrangements?

**Consultation responses**

5.37 Responses to the consultation were wide ranging, and either strongly supported the introduction of Special Administration or strongly opposed it.

5.38 Respondents who supported the introduction of Special Administration stated that it would protect consumers from any unforeseen effects of insolvency and that airports were sufficiently important assets to the UK economy to require the Government to take steps to ensure their continued operation. They also, on the whole, stated that it should be introduced along the same lines as other regulated regimes. One respondent stated
that although there is a low risk that a key airport would close due to insolvency, the costs associated with such a closure would be particularly high and therefore Special Administration should be introduced.

5.39 Respondents who were strongly opposed to the introduction of Special Administration argued that it would be a disproportionate response to the risk of an airport ceasing to operate upon insolvency. Respondents were concerned that such a move would make the industry less attractive to investors, particularly given the importance attached by investors to security over airports assets due to the industry’s cyclical nature. Therefore, if security were to be taken away from lenders it would present a significant barrier to investment.

Government’s decision

5.40 In its consultation, the Government made it clear that it would only introduce Special Administration if its benefits outweighed its costs. The evidence gathered and verified by Government from the consultation, persuaded the Government that the costs of introducing a Special Administration regime would outweigh the benefits. To that end, the Government announced in October that it would not introduce Special Administration. In order to protect consumers by minimising the risk of closure of an airport upon insolvency, the Government has announced a consultation on a possible licence condition requiring Tier 1 airport operators to produce and maintain a Continuity of Service Plan (CSP), which is published alongside this decision document. The CSP is intended to minimise disruption to the business on transition of control from an insolvent operator to an insolvency practitioner. A CSP would also provide some protection to passengers by mitigating the low risk of closure upon insolvency.

5.41 The Government believes that the costs relating to the introduction of the Special Administration regime arise from the impact necessary changes to financing arrangements will have on investment. Credit rating agency publications advised that the introduction of Special Administration could precipitate a ‘multi notch downgrade’ (Standard & Poor’s, 28 September 2009). Government analysis shows that the impact of introducing Special Administration, through a requirement for lenders’ and bondholders’ consent, could precipitate financial distress to airport operators. This is because airport operators would require a change to the financial arrangements that lenders have entered into with operators. Such a change to the financial arrangements would require consent from operators’ lenders and if that consent were not given or a high fee were charged for it, then it would significantly deter investment in both the short and long term, which would not be in passengers’ interests.

5.42 Analysis conducted by Government and its advisors demonstrates that the cash generative nature of an airports business makes the continued operation of a Tier 1 airport upon insolvency likely and therefore the risk of closure low. This has led the Government to conclude that while Special Administration is intended to guarantee that airports will stay open, the benefits of Special Administration are low relative to the disruption to investment which its introduction could cause.
5. Promoting financial resilience

Summary of key decisions

5.43 The financial resilience package consists of:

- A supplementary financing duty for the CAA that is similar to the duty many other UK economic regulators have.

- A minimum credit worthiness requirement for airports and ring fencing provisions similar to those in place in the energy, water and rail sectors for Tier 1 airports. There will be initial derogations for some of these ring fencing provisions because the costs of introducing those provisions currently exceed their benefits.

- A consultation on a mechanism to ‘switch on’ those ring fencing provisions granted derogations upon the introduction of the licence in order to move to a full ring fence over time. The granting and removal of future derogations would be a licence modification matter and is outside the scope of the consultation published alongside this document.

- A consultation on a licence condition that would require Tier 1 airports to produce and maintain a CSP for use in the case of insolvency. We have decided that the benefits of Special Administration are not sufficient to support its introduction.
6. Enhancing accountability

Introduction

6.1 This chapter explains how the Government proposes the regulator should be held to account for its decision making and the regulator’s general performance in a new regulatory regime. The most important mechanism for ensuring regulatory accountability is appropriate provision for affected stakeholders to challenge the Civil Aviation Authority’s (CAA) decisions to an independent body and the lack of an appropriate merits-based appeals mechanism in the existing regulatory system is one of its most fundamental shortcomings.

6.2 The responses to the consultation have highlighted areas where there is a high degree of consensus and provided useful and detailed comment on those issues for which no consensus emerged. Further, the responses help to identify how the design of the appeals framework can be adapted to produce a system which is fit for purpose and which balances competing interests.

6.3 It is generally agreed that the new legislative framework should provide specific appeal mechanisms for both Tier 1 decisions and licence modification decisions (including those relating to price regulation and service quality). There is general agreement that rights to apply for judicial review for all parties are not, on their own, sufficient redress, and that in any appeal framework, provisions to limit frivolous, vexatious or unmeritorious claims will be necessary.

6.4 It is clear from the responses that the issues of (i) who can appeal (ii) over which decisions and (iii) under which processes are inextricably linked. The wish to enable interested parties to have rights of appeal is to be balanced against the concerns that appeals become too numerous or take too much discretion from the regulator or that the system otherwise becomes unduly inefficient. The CAA expressed this concern by wishing to see a system which is proportionate and balanced and which in particular is not both broad in the right of appeal and deep in the level of scrutiny.
In the remaining sections of this chapter we explain the Government's proposals for:

- Mechanisms for appeal of CAA decisions;
- the appeal of decisions relating to Tier 1 status;
- the appeal of proposed licence modifications; and
- the procedural processes appropriate for those appeals.

Mechanisms for appeal of CAA decisions

Government's proposal

In the consultation, the Department for Transport (DfT) considered whether and to what extent the economic regulation decisions of the CAA should be capable of challenge and, if so, how and by whom. The consultation noted that how a decision may be challenged can have a material effect on the process adopted for the making of that decision, and can affect the quality, certainty, and robustness of that decision and the regulatory system overall. The DfT noted that while the regulatory framework should satisfy fundamental principles regarding the ability of persons affected by regulatory decisions to challenge them, it should also ensure that the mechanisms do not unduly undermine the overall workability of the regulatory regime.

In undertaking this review, the DfT recognised that there are certain fundamental principles that must be acknowledged in the design of any challenge mechanism. These principles include Article 6 of the European Convention of Human Rights (Schedule 1 of the Human Rights Act 1998) and the principles of natural justice.

The DfT noted that under the current statutory framework, judicial review is the only means of challenging regulatory decisions of the CAA under Part IV of the Airports Act 1986. Judicial review does not allow for review of the underlying substance of a decision and in general the Courts will not substitute one decision of a public body for another decision, although they may quash the decision taken and/or refer it back for further consideration. Judicial review does not generally allow for a challenge to a regulator’s factual findings (though the court will consider if irrelevant matters have been taken into account or relevant ones ignored) and a challenge to the conclusions they reach on the basis of these findings is limited to consideration of whether the conclusion was irrational or perverse. While judicial review would be available as a potential avenue of challenge for any party with sufficient interest in the outcome of the regulatory decision-making process, the DfT considered whether it is appropriate for the new legislative framework to include specific mechanisms for certain parties to challenge CAA decisions in addition to the rights of affected parties to apply for judicial review of those decisions.

The appeal of CAA decisions in relation to enforcement orders and penalties imposed on the licensee under the licence are discussed in Chapter 4.
6.9 The consultation proposed that CAA decisions on Tier 1 status should be subject to a right of appeal over and above the right to apply for judicial review. The DfT’s proposal was for a merits based appeal for all affected parties to the Competition Appeal Tribunal (CAT). The consultation also proposed a number of options for a merits based appeal of decisions related to licence modifications. The consultation asked for specific views and comments regarding (question 8.1):

- The proposed approach to allowing appeals regarding CAA decisions about whether an airport should have a Tier 1 licence and regarding licence modifications.
- Which parties should have the right to appeal and on which decisions particular parties should have the right to appeal.
- The most appropriate approach to ensure that appeals are neither frivolous nor vexatious.

Consultation responses

6.10 The overwhelming consensus from responses received is that an appeal mechanism of some form is desirable for both Tier 1 and licence modification decisions and that there should be appropriate provision for affected stakeholders to challenge the CAA’s decisions to an independent body. No response argued for judicial review alone being sufficient, although, as commented on further below, a number of respondents argued that the right to apply for judicial review would be sufficient for a number of parties in relation to a number of decisions. A number of respondents commented specifically on which parties should be able to appeal which decisions and on ways in which to avoid frivolous and vexatious appeals. These comments are summarised and commented upon in later sections of this Chapter. We set out below some general comments we have received from the Competition Commission and the CAA on the general approach, which it is suggested we adopt and the types of merits based appeal that may be available. Other respondents did not comment on these general themes and their comments on specific aspects of appeals are discussed elsewhere in this Chapter.

6.11 The Competition Commission\(^{42}\) noted that the design of objectives and duties should anticipate not only the system working well, but also guard against the eventuality that on occasion it may not. The Competition Commission noted that this is also an important consideration in identifying an appropriate appeal system. The Competition Commission noted that the most important question is the degree of accountability that is sought, and that this bears directly on the question who should have standing to appeal and on the standard of review.

\(^{42}\) The Competition Commission’s comments are taken from its report on the supply of airport services by BAA in the UK, available at http://www.competition-commission.org.uk/inquiries/ref2007/airports/index.htm
6.12 The CAA welcomed the DfT’s proposals to modernise the current system. The CAA believes the current system reduces flexibility and accountability whilst resulting in a convoluted and time consuming process. The CAA acknowledged that a well designed appeals process can contribute to the stability of the regulatory framework, by exposing regulatory decisions to additional scrutiny and reducing regulatory risk. The CAA also acknowledged that it is important to ensure that there is an appropriate balance between regulatory discretion and accountability. The CAA believes that a modernised appeals regime could form a useful element to achieving an appropriate balance, whilst also offering the potential to streamline the current cumbersome process whereby price controls are automatically subject to review by two regulators. The CAA makes the point, however, that the appeals process needs to be seen in the context of other measures that hold the regulator to account, such as the regulator’s accountability to Parliament, judicial review, and ensuring that the regulator has a set of clear statutory duties. The CAA believes that the updated appeals process needs to complement the overall package of reforms and encourage timely regulatory decisions that reflect the statutory duties. The CAA believes the appeals process needs to address three challenges:

- The regime needs to be proportionate to the importance of the decisions and the impact on consumers and other affected parties. There should be no presumption that the same appeals process would be appropriate for all CAA decisions and the CAA welcomed the DfT’s acknowledgment of this principle;
- an appeal is likely to expose a number of parties to additional costs and these are likely to affect the licensed airport more than other parties. The asymmetry in incentives between the airport operator and its airline customers needs to be addressed in the appeal mechanism; and
- regulatory decisions involve judgments where there is unlikely to be a “correct” answer. This raises the issue of how any award of costs would operate. It also increases the chance that an appeals body will, if it needs to reach its own independent assessment of the answer, tend to depart, at least in part, from the original decision.

6.13 Both the Competition Commission and the CAA commented on the different appeal procedures that could be adopted and which would affect the level of scrutiny and which could affect the scope of appeal rights. The Competition Commission drew a distinction between what it termed an investigative appeal compared with an adjudicative appeal process. In the Competition Commission’s view, the most important features of an investigative approach are the following:

- The Competition Commission will reach its own decision on the issue (e.g. the licence modification) applying the relevant regulatory duty;
- it will do so having regard to all the evidence, including all the evidence that comes to light after the regulator’s decision and having received evidence from and held hearings with, all interested parties. The Competition Commission will give directions as to the evidence which it wishes to receive and may commission its own evidence through, for example, customer surveys;
investigations can be lengthy processes taking between six and twelve months;
investigations tend to place a significant burden on the regulated company; and
whilst not impossible, it is not easy to apply a permission stage\textsuperscript{43} to an investigation nor is it easy to award costs against the parties as the identification of winners and losers can be difficult.

6.14 In the Competition Commission’s view the most important features of an adjudicative approach are the following:

- The Competition Commission will only assess the merits of the regulator’s decision in so far as the merits of the decision are put in issue by the appellant and on the basis of the objections made by the appellant;
- the appellant will initiate the appeal by filing a full statement of objections to the regulator’s decision and this statement will define the dispute;
- the evidence that is relevant will be that submitted by the parties;
- these types of appeals lend themselves to the identification of winners and losers and hence to the award of costs;
- these types of appeals are also amenable to a permission stage to filter out unmeritorious challenges; and
- in an adjudicative appeal process, the burden falls most heavily on the regulator who has to defend its decision. While the regulated airport may be expected to participate this is not as heavy a burden on the regulated airport as an investigation.

6.15 The CAA made a number of similar, though different, comments in this regard. The CAA distinguished between a number of different forms of appeal;

- Process appeals such as judicial review;
- merits based appeals where the regulator’s decision (rather than the process) is assessed to identify whether it reasonably discharges the statutory duty,\textsuperscript{44} and
- referral of a decision to an alternative body for the decision to be re-assessed.\textsuperscript{45}

\textsuperscript{43} A preliminary stage in the process at which the appeal body considers if there is sufficient merit in the dispute to allow it to proceed to a full enquiry.
\textsuperscript{44} This appears similar to the adjudicative system described by the Competition Commission.
\textsuperscript{45} This appears similar to the investigative system described by the Competition Commission.
6.16 The CAA acknowledged this distinction is somewhat stylised but illustrates that there are a number of ways in which an updated system of appeals could be introduced. In particular, the CAA noted that the appeals regime needs to establish the appropriate degree of discretion afforded to the regulator. The CAA noted the current approach, judicial review, allows parties to challenge the merits of the decision only where the regulator has acted irrationally. In contrast, the referral approach used in other regulated sectors results in the original decision being set aside and obliges the Competition Commission to retake the decision without affording any further discretion to the regulator. The CAA notes that between these two extremes it is possible to construct a range of procedures whereby the regulator’s decisions will be subject to appeals to varying degrees, thus affording the regulator more or less discretion to take decisions that it considers best meets its statutory duties. The CAA put forward an example where the appeals regime permits appeals where the regulator has failed to demonstrate that it acted “reasonably”. The CAA noted that these distinctions are not semantic as they fundamentally affect the responsibility afforded to the CAA for the economic regulation of airports. Too much discretion to the CAA could undermine accountability but too little could reduce the role of the CAA to such a degree that the appeals body becomes the de facto decision making body.

Government’s decision

6.17 The Government agrees with the general consensus that a form of appeal mechanism is required for the appeal of Tier 1 decisions and the appeal of licence modification decisions including those relating to price regulation and service quality. It also agrees with the general consensus that while the regulatory framework should satisfy fundamental principles regarding the ability of persons affected by regulatory decisions to challenge them, the mechanisms should not unduly undermine the overall workability of the regulatory regime.

6.18 It is generally accepted that the framework should be proportionate, allow appropriate provision for challenge and should properly ensure regulatory accountability. There is less agreement however about how the framework should reflect this. In particular, there are a number of contrasting views discussed later in this Chapter, on which parties should have the right to appeal specific decisions and how the nature of the category of potential appellant and the appeal procedure can support or unduly undermine the objectives of proportionality and accountability.

6.19 In the following sections of this Chapter, we analyse the consultation responses in relation to the appeal of Tier 1 decisions and separately the appeal of licence modification decisions. The decisions reached in these sections are necessarily related to the procedures that are being recommended for the appeals process for those decisions, and those processes are commented upon in the final section of this Chapter.
Appealing regulation under a Tier 1 licence

Government’s proposal

6.20 In the consultation, the DfT proposed that the CAT would be the appropriate appellate body for Tier 1 decisions, stating that the CAT would have to grant permission for the appeal to proceed and could refuse permission if the CAT was of the opinion that the appeal was frivolous, vexatious, or had no reasonable prospects of success.

6.21 The DfT suggested that Tier 1 decisions should be subject to a merits based appeal by all parties with a material interest including the licensee, airlines, specified consumer groups and other airport operators. In the consultation, the DfT noted that the decision to regulate an airport under a Tier 1 licence, or remove regulation at that level, is a decision of great importance and carries with it potentially significant commercial implications for airports (directly), and for airlines and consumers (indirectly), not only at the affected airport itself but also at other airports within the affected area/market.

6.22 The DfT proposed that each Tier 1 airport should be periodically evaluated by the CAA against the specified criteria for Tier 1 to assess whether the degree of scrutiny and regulatory control that these licences will entail is necessary. This clause is known as the ‘sunset’ clause. It noted that a five yearly review may be appropriate and would provide an element of continuity with the current well understood quinquennial price control system. The consultation also suggested, however, that the independent regulator should be granted flexibility in the new regime that would allow the time period for price regulation to vary as the DfT believes that this may be positive for providing appropriate investment incentives and more generally allow the CAA to put in place the most appropriate form of price regulation. The DfT proposed to specify that this assessment be taken in sufficient time so as to come into effect at the end of each period of price regulation.

6.23 The consultation asked the following specific questions (question 8.2):

- Do you agree with the proposal that the CAA would be required to consider the regulatory status of a Tier 1 airport at the end of each period of price regulation (the sunset clause)?

- Do you agree with the proposal that CAA decisions about whether an airport should have a Tier 1 licence should be subject to a merits based appeal to the CAT?

- Do you agree that access to merits based appeal on the CAA’s decision about whether an airport should have a Tier 1 licence should be granted to all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators?

- How should provision be made in the new regime to deter frivolous or vexatious appeals?
Consultation responses

6.24 A number of respondents including the CAA, British Airways (BA), Virgin, easyJet and Manchester Airport Group (MAG) agreed that the CAT was the appropriate appeal body for Tier 1 decisions.

6.25 Gatwick Airport, BAA and the Competition Commission argued that the Competition Commission was the appropriate appellate body although acknowledging that both the Competition Commission and the CAT have the necessary capability and experience. BAA believes there is merit in one body handling all appeals to ensure a joined up approach and believes the Competition Commission is best placed to handle this.

6.26 On the issue of which parties should have standing to appeal, the majority of respondents (including all airlines and other interest groups who commented) supported the DfT’s proposal that all parties with a material interest should be able to appeal Tier 1 decisions.

6.27 BAA argued that all parties with a material interest (as defined by BAA) should have the ability to appeal Tier 1 decisions but that material interest needed to be defined. BAA suggested a threshold so that an airline can only appeal Tier 1 status when that airline (or a group of airlines which jointly agree to bring the appeal) individually (or together) represent at least 50% of either passenger volume aircraft movements or cargo tonnage at a particular airport.

6.28 Gatwick believes only the airport operator itself should be able to appeal Tier 1 decisions. Gatwick does, however, support any party being able to bring forward a proposal to change the tier status of an airport operator.

6.29 London Luton Airport (LLA), Belfast and Cardiff International airports suggested that the most productive way of ensuring efficiency in practice would be to reduce the number of appellants to the minimum appropriate level. They do not, however, suggest what this minimum appropriate level would specifically be.

6.30 Few respondents commented in detail on the nature of the appeal though there appears to be a consensus that the appeal should be merit based. Respondents did make a number of responses concerning the control of frivolous or vexatious claims and these are discussed further in the final section of this Chapter.

6.31 The Competition Commission did not comment expressly on the nature of a Tier 1 appeal. However, in its comments the Competition Commission specified that there are likely to be aspects of those decisions that lend themselves particularly to the Competition Commission’s established investigatory procedures.

6.32 The CAA suggested the appeal should be a merits based appeal rather than a referral appeal. The CAA suggested perhaps an appeal should be permitted if the CAA has failed to demonstrate that the original decision is reasonable when assessed against its statutory duties. The CAA suggested that the appeal decision would be to strike down the original decision and refer the matter back to the CAA for further consideration.
Few respondents disagreed with the proposal for a sunset clause and a number including BAA, CAA and the Air Transport Users Council (AUC) were expressly in favour. BA and easyJet were in favour of a review only when circumstances had changed to suggest a review was required, this leading in their view to increased regulatory certainty and to be more in line with better regulation principles.

**Government’s decision**

6.34 There is a general consensus that, in addition to the right for affected parties to apply for permission to seek a judicial review of Tier 1 decisions, those decisions should also be subject to specific rights of appeal.

6.35 There is a consensus that the airport operator should have the right to appeal Tier 1 decisions.

6.36 There was no consensus on whether other parties affected by a Tier 1 decision should have specific rights of appeal although the majority of respondents supported that position. Having considered in detail the arguments put forward by all of the respondents, it remains the **Government’s view that all parties with a material interest should have standing to appeal Tier 1 decisions. This would expressly include Passenger Focus as the body empowered to represent passengers’ interests.** Those respondents who argued for a different position were concerned about the effectiveness of the system overall and avoiding appeals being brought by parties with only a small interest at the relevant airport. In the context of Tier 1 decisions and on the basis of appeal processes which we discuss below, the DfT is satisfied that this concern can be addressed by the appellate body determining whether the appellant has satisfied the materiality threshold. It is the DfT’s view that the appellate body is best placed to determine those parties materially affected in the context of the particular facts and furthermore the appellate body would be able to develop and use its appeal procedures to control any aspects of an appeal which lacked merit or substance. However, there is a public interest in ensuring Tier 1 decisions are taken properly so as to comply with the requirements of the Airports Charges Directive (ACD). Against this background, it is plainly appropriate and necessary that the Secretary of State be entitled to appeal Tier 1 decisions to the CAT.

6.37 The DfT has considered in detail all of the responses concerning who the appropriate body should be in relation to the appeal of Tier 1 decisions. The DfT has noted that many respondents supported the DfT’s original proposal that this should be the CAT. The DfT has also noted that a number of respondents supported the Competition Commission as the appeal body. It is the DfT’s view that both the CAT and the Competition Commission have the capability and the experience to hear Tier 1 appeals and that the judgment is a fine one. On balance, the **Government remains of the opinion that, as proposed in the Consultation, Tier 1 appeals should be appealed to the CAT.**
6.38 As noted above, there was little comment from respondents specifically on the type of appeal appropriate for Tier 1 decisions. The CAA expressly supported an adjudicative approach based perhaps on an assessment of whether the CAA's decision was reasonable measured against its statutory duties. The DfT has considered carefully the type of appeal which would be most appropriate for the appeal of Tier 1 decisions in view of the DfT deciding that all parties with a material interest in the decision will have standing to appeal and in view of the wish to support the CAA's role as the primary regulator and decision making body for Tier 1 decisions. **The Government has decided that this would be best achieved by allowing affected parties to appeal under an adjudicative rather than an investigatory appeal framework.** The Government believes that an adjudicative appeal for Tier 1 decisions, as discussed in more detail later in this Chapter, should enable claims to be dealt with as efficiently as possible and should help to discourage and/or dismiss any unmeritorious claims, e.g. through the permission stage and the award of costs. This should provide some assurance that the system will not become inefficient with the wider category of potential appellants. The procedure would also generally leave the CAA as the ultimate body determining an airport’s tier status. The precise test to be applied by the CAT in any appeal of a Tier 1 decision is continuing to be developed. The DfT has considered the proposal put forward by the CAA and has also considered appeal mechanisms under alternative frameworks, including those under the Energy Code Modification regime, the Communications Act 2003 regime and the appeal of decisions under the Competition Act 1998, as well as the test for appeals from High Court decisions. The DfT is currently minded to pursue a test based upon whether the CAA's original decision can be said to be wrong in law or fact or based on the wrong exercise of discretion.\(^{46}\)

6.39 The DfT notes that the majority of respondents supported the DfT’s proposals in relation to a sunset clause (i.e. a mandatory review of whether or not the airport should continue to be licensed within Tier 1). The DfT has considered the comments of BA and easyJet but does not accept that a sunset clause is likely to cause instability or encourage deregulation in circumstances where that would not otherwise be appropriate. It is the DfT’s view that the sunset clause will in fact encourage appropriate and proportionate regulation and embed good regulatory practice. The DfT agrees that the status of a Tier 1 airport should also be reviewed if circumstances are relevant to the criteria change. It therefore remains the DfT’s view that the sunset clause will reinforce the principles of better regulation and **the Government has therefore decided that the new framework will require the CAA to consider the regulatory status of a Tier 1 airport at the end of each price regulation period.**\(^{47}\)

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\(^{46}\) The CAT would be able to uphold a decision, quash it or remit it back to the CAA with or without directions.

\(^{47}\) The CAA will also have to consider on a regular basis or on request from an interested party whether airports in Tier 2 or those not subject to price control are subject to effective competition. This requirement arises from the Airport Charges Directive and the Government will be consulting in 2010 on how it proposes to transpose this directive.
Appealing the modification of licence conditions

Government's proposal

6.40 In the consultation, the DfT noted that it had considered the mechanisms in other regulated industries for the modification of licence conditions and the appeal mechanisms applying to challenge those and other decisions by the regulator. In the context of the new framework for the economic regulation of airports, the modification of licence conditions would, in relation to Tier 1 airports include the modification of conditions relating to price regulation and/or service quality.

6.41 The consultation noted that each of the water, gas, electricity, NATS and rail regulatory regimes contain detailed provisions for the modification of licence conditions and procedures where modifications are not agreed. It was noted that the procedures have a number of standardised features which are summarised below. It was also noted that the provisions for telecoms and some energy codes are different from these standardised processes, and in particular, include some provisions that allow for appeals by other interested parties.

6.42 The standard regime allows for the modification of a licence condition by agreement between the regulator and the licence holder. In general, the regulator will be required to give notice to the licence holder of proposed licence modifications and the licence holder will then have a period of time, typically not less than 28 days, within which to object to the proposal. The proposal will also typically be required to be published such that all interested parties are made aware of, and are allowed to object to, the proposals. The Secretary of State may be able to exercise a limited right of veto over the proposals. The regulator is typically able to seek to modify particular licences to address matters which, in the regulator’s view, adversely affect the public interest. This procedure is effectively invoked as an appeal mechanism when the regulator and company cannot agree on a licence condition change. This procedure requires the regulator to refer the matter to the Competition Commission who will recommend modifications to the licence if the Competition Commission agrees that the public interest is adversely affected. If the Competition Commission finds that no matter operates against the public interest, its decision is final, and no change would be made to the licence condition. If the Competition Commission agrees that certain matters operate against the public interest, the regulator will then propose modifications which the regulator believes are appropriate to address the concern. If the Competition Commission agrees, then these modifications will be implemented. If the Competition Commission does not

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48 This section does not discuss the process for modifying licence conditions relating solely to the Airport Charges Directive (ACD). As discussed in Chapter 4, only the Secretary of State will be able to modify licence conditions solely related to the ACD.

49 Modification is defined as including additions, alterations and omissions – see, for example, section 219(1) Water Industry Act 1991.

50 See, for example, section 17(5) Water Industry Act 1991.

51 We understand that in considering whether or not a proposed licence modification operates against the public interest, the Competition Commission will consider the issue on the same basis as the regulator – that is having regard to the specific regulator’s statutory duties.
agree with the regulator’s proposed modifications, then it can impose its own modifications. This procedure involves interested parties (including all licence holders and the Secretary of State) being notified of the reference initially and at various stages of the process.

6.43 The consultation noted that within this “standard” framework the regulator has no substantive right to modify licences without agreement and that, where there is no agreement, it would appear reasonable for any decision to modify to rest with the Competition Commission. The consultation noted that a key issue for the operation of a reformed regulatory system will be the extent to which rights of appeal on licence modification decisions should be granted if at all, beyond the airport operator.

6.44 The consultation noted it is arguable that, because the decisions on price regulation and service quality are sufficiently important and so directly impact both airlines and passengers, it is right for those parties to have a direct right to refer the matter to the Competition Commission if any proposed settlement by the CAA is not acceptable to them. However, the consultation also noted that the Expert Panel considered that all parties should only have a right to appeal an airport operator’s statement of charging principles, with the price control (or alternative form of price regulation) itself subject only to appeal by the airport operator. The consultation noted that the Expert Panel believed that opening up merit based appeals more broadly than this would result in the system being overwhelmed and slowed down by appeals which would have the unintended consequence of the Competition Commission becoming the effective sectoral regulator. The consultation noted that the Expert Panel considered that the right to appeal for airlines and passenger representatives should be limited to two decisions:

- whether an airport has a Tier 1 licence; and
- challenging a CAA decision to approve an airport’s statement of charging principles.

6.45 In the consultation the DfT invited views generally on this issue but also suggested three options as follows (question 8.3):

- Option 1 – rights to a merits based appeal on all licence modifications granted to all parties with a material interest including the licensee, airlines, specified consumer groups and other airport operators.

- Option 2 – rights to a merits based appeal on all licence modifications granted to the licensee. A right of appeal for other parties with a material interest (including airlines, specified consumer groups and other airport operators) on a limited range of issues including but not limited to the CAA’s decision on Tier 1 licences. Sub options on how appeal rights could be extended beyond the licensee include:
  
  (i) a right of appeal on the CAA’s decision to endorse an operator’s statement of charging principles setting out how a price control once set will be translated into the detail of airport charges; and

  (ii) a right of appeal on a statement of principles by the CAA setting out the fundamental basis on which price control decisions are made.
• Option 3 – rights to a merits based appeal on all licence condition changes granted to the licensee. Other parties with a material interest (including airlines, specified consumer groups and other airport operators) granted access to a merits based appeal on the decision whether an airport should have a Tier 1 licence but not to licence modification decisions.

6.46 In the consultation, the DfT also set out a proposed approach as follows for licence modification decisions and appeals of those decisions, irrespective of which parties have a right of appeal:

• The process for licence modification should be set out in legislation and require the CAA to consult fully. The process should require the regulator to engage in discussion with all parties affected (including the airport operator, airlines and passenger groups);

• the CAA should be required to obtain, and provide to all parties with a right of appeal, information sufficient to enable them to make informed contributions to any discussion/negotiation and to assess the merit of any proposed decision;\(^52\)

• in relation to proposed licence modifications the process should require the CAA to publish a proposed determination and for affected parties to have a further opportunity to comment following publication but before a final determination is made by the CAA;

• following publication of the CAA's final determination on price regulation or service quality matters, the relevant parties should have the right to require that the matter is referred to the Competition Commission for determination;

• the Competition Commission would determine the issue referred to it on the same basis upon which the CAA considered the issue;

• a statutory timescale for the issue to be determined by the Competition Commission in line with the timetable adopted in other sectors (usually not longer than six months) should be adopted;

• the CAA should be required to implement the modifications (including any related to price regulation or service quality) in line with the Competition Commission's determination; and

• the Competition Commission should be able to make a costs order against any affected party in relation to the Competition Commission's own costs or the costs of any third party.

6.47 This proposal is essentially an investigative appeal. It is a proposal which is to a significant extent modelled on the licence modification challenge procedures in a number of the other regulated sectors.

\(^52\) The precise nature of this information and any confidentiality issues related to its disclosure and subsequent dissemination and use will need to be considered in detail.
6.48 In addition to seeking views on the three options, the consultation specifically sought views on two questions (questions 8.4 and 8.5):

- Does a procedure which involves either the agreement of the licensee only or a determination of the public interest by the Competition Commission properly take account of airline and other third party views?
- Should airlines and other third parties have a specific right to be consulted on proposed licence modifications?

Consultation responses

6.49 There is a consensus that the relevant airport operator should have the right to appeal licence modification decisions. All respondents supported the right and none argued for a contrary position.

6.50 A number of respondents, particularly airlines and interest groups (including BA, Virgin, easyJet, Campaign to Protect Rural England (CPRE) and Strategic Action Special Interest Group (SASIG)), expressly supported Option 1 which proposed rights of appeal to licence modifications to all parties with a material interest. BA, for example, supported Option 1 and believes regulators should be subject to credible threats of challenge to poor decisions from both sides to ensure decision making is not influenced by the threat of an appeal from one side only. BA further argued that judicial review is not sufficient given the inability of the Court to review the factual or other basis of the regulator’s decision and the regulator’s wide discretion because decisions which could have critical consequences for the airline may nevertheless be within the ambit of the regulator’s reasonable discretion.

6.51 easyJet supported Option 1 arguing that an airline right of appeal will be a useful check against any regulatory decisions that do not reflect passenger interests. Virgin also supported Option 1 and a symmetrical right of appeal. Virgin regards Options 2 and 3 as inadequate to ensure accountability of the regulator and regulatory decisions. The right of appeal simply on a statement of principles (Option 2) would, in Virgin’s view, be insufficient. For example, Virgin refers to the CAA’s Q5 Price Control Decision in 2008 and states it was not the policy but the application of it with which Virgin disagreed. Similarly, Virgin noted that easyJet’s judicial review focused on the application of Operational expenditure (opex) not the principle of including an Opex projection. Virgin believes a right of appeal equal to Option 2 would leave parties with an appeal process fraught with problems similar to those on judicial review. A number of respondents noted that in many instances the interests of passengers and airlines are aligned.

6.52 The Competition Commission believes the starting point to consider standing to appeal is that a system of appeals should provide accountability. Accountability, in the Competition Commission’s view, is best provided by allowing those persons with a material interest at stake to defend that interest. Further, basic perception of fairness suggests that people should be able to defend their own interests. In relation to airport charges and levels of service and quantity of airport services, the interests of the airport, of airlines and of passengers are all engaged. The Competition Commission therefore favours a presumption that individual airlines (as well as the airport and nominated passenger groups) should have standing to appeal.
6.53 The Competition Commission expressly supported designated passenger groups having standing to appeal and the Competition Commission recommended that the DfT should consider which groups to designate for this purpose.

6.54 The CAA expressed concerns that Option 1 could, depending upon the detail of how it is structured, undermine timely and efficient decision making. The CAA did not comment specifically on whether it supports or objects to airlines having the right of appeal, but the CAA indicated concerns in this regard which it would wish to see addressed in the overall framework, if the proposals are to ensure the structure is proportionate and deal adequately with the harms the CAA identified. In particular, the CAA commented that Option 1 gives the highest degree of scrutiny but the lowest degree of discretion to the regulator. The CAA is concerned that this could undermine timely and efficient decision making, prompting appeals wherever interests are threatened. This risk the CAA identified as particularly acute on a referral type appeal as the process is time consuming and, with the difficulty in identifying winners and losers, there is difficulty in costs awards acting as an effective deterrent against a party triggering an appeal to delay implementation. The CAA acknowledged that the risks in allowing appeals by a broad range of parties is reduced if a narrower merits based, adjudicative appeal model is used, but the CAA also noted that there was an asymmetry in incentives between the airport operator and its airline customers which any system would need to address.

6.55 Manchester Airport Group (MAG), Gatwick, BAA and some other airport operators did not support Option 1. MAG was cautious about extending appeals generally beyond the licensee because of regulatory gaming concerns. MAG supported Option 2 (and was the only respondent to do so) and believes airlines and third parties should (in addition to the right to appeal Tier 1 decisions) have the right to appeal the CAA’s decision to endorse an airport operator’s statement of charging principles but not otherwise.

6.56 Gatwick noted that a price control decision is made following extensive consultation by a regulator and is typically a balanced combination of a large number of inputs. Gatwick considered the case for allowing appeals for other licence modifications to be more balanced. A “route of appeal” may, in Gatwick’s view, “crowd out” commercial negotiations. However, Gatwick conceded there are some merits in allowing appeals by third parties since this would provide checks and balances on the CAA. Gatwick also suggested that, if airlines are to be allowed to appeal, a threshold could be applied so that only major airlines (and perhaps a designated industry representative) could appeal regulatory decisions. It did not specify what that threshold would be.

6.57 BAA believes the right to appeal the CAA’s licence modification decisions should be limited to the relevant airport operator. The costs of launching an appeal would be relatively low for third parties including airlines. Consequently the likelihood of third party appeal would be relatively high creating significant and inefficient disruption to the regulatory process. BAA therefore favoured Option 3. BAA has been conscious of how licence
modifications have operated in other regulated sectors and established a balance between the regulator and the licensee whereby the process encourages both parties to accept compromises to avoid unnecessary appeals being taken to the Competition Commission. This has, in BAA’s view, been a key feature of utility regulation in the UK and has achieved a reasonable balance of tough outcomes but relatively efficient processes. BAA believes the balance which has worked well in other sectors would work well in the airports sector.

6.58 For these reasons BAA opposed Option 1. BAA notes the intention to give additional rights to airlines in the new process, relating to consultation and information disclosure. In BAA’s view, judicial review could take account of procedural irregularities.

6.59 In relation to Option 2, the CAA noted that with the right of appeal limited to the regulated company on most matters this would likely mirror the licence modification process in other sectors. The CAA does not comment on whether it favours this approach though does note benefits of it. The CAA also commented on the two sub options proposed by the DfT. The CAA noted the underlying assumption of sub-option 1 is that a Tier 1 airport will be subject to price control rather than the CAA having discretion whether to impose price control on a Tier 1 airport. The CAA commented that the consultation does not define the statement for sub-option 2 in detail, and requested that the DfT clarified its approach further, but that a workable approach would be to limit the high level issues to:

- The choice between a single till and dual till approach;
- the choice between a stand alone and system regulation approach;
- the decision whether to apply a price cap or to restrict regulatory intervention to price monitoring.

6.60 Many of the responses did not consider expressly who the appellate body should be to consider licence modification appeals. Those that did such as BAA, International Air Transport Association (IATA) and Virgin supported the Competition Commission as the appropriate body for licence modification decisions. BA noted the possible concern over multiple appeal bodies but concluded that appeals should be to the appropriate agency whichever that is. Most other responses assume, and appear comfortable with the Competition Commission as the appeal body. No response argued expressly for any alternative position.

6.61 The Competition Commission noted the broad agreement that appeals should be made to the Competition Commission on their merits and they should take place after the regulator has made its final decision. The Competition Commission supports that consensus.

6.62 The Competition Commission noted the general consensus that an appeal should be on the merits of the CAA’s decision i.e. that the appellate body can engage in the substance of the issues. A merits based appeal is supported by most respondents who commented on the issue. The Competition Commission and other respondents’ detailed comments on the nature of such a merits based appeal is discussed elsewhere in this Chapter.
Government’s decision

6.63 The DfT notes the general consensus that licence modification decisions by the CAA should be subject to appeal and that the Competition Commission is the appropriate appeal body. **The Government has therefore decided that the Competition Commission should be the appeal body for the appeal of licence modification decisions.**

6.64 The DfT also notes the consensus that the airport operator should have the right to challenge or object to CAA licence modification decisions. In this document, the right to challenge or object to such decisions is referred to as a right of appeal. The DfT agrees and **the Government has therefore decided that the airport operator should have the right to appeal against CAA decisions of licence modifications.**

6.65 The principal issue relating to the appeal of licence modification decisions for which no consensus has emerged is which other parties should have the right to appeal, and whether other parties’ appeal rights should be limited to a narrow set of decisions only. The DfT has been aware that there is no consensus on this issue and that there are indeed strongly held and opposing views on all sides.

6.66 In considering its position in the light of this divergence of views, the DfT has been concerned to ensure that the Government’s proposals for the appeal of licence modification decisions provide a proportionate, balanced and efficient framework within which the CAA is required to make fair and balanced decisions against its statutory duties and under which appeal rights provide an appropriate level of review and accountability.

6.67 As well as having considered carefully all of the responses received to the consultation, the DfT has considered information available on procedures in other regulated regimes including discussions on whether appeal rights should be extended in the context of those other regimes. It is apparent from this information that there is similarly no consensus in other regulated sectors as to whether rights of appeal should generally be extended beyond the regulated company.

6.68 As detailed in the consultation and referred to above, the DfT has taken as its starting point the “standard” current position in most other regulated sectors under which it is only the regulated company which can challenge and oppose proposed licence modifications. If you start with the existing “standard” approach there is no compelling evidence to demonstrate that these models are operating ineffectively in practice. It does not, however, follow that other structures may not be more appropriate in the airports sector and/or may be an improvement on the “standard” model. The DfT has therefore considered if it is appropriate in the light of consultation responses for rights of appeal to be extended in the new airports regime.

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53 Including the practice and procedures in the telecoms and energy code processes under which extended rights of appeal exist.

54 For example the current discussion in the energy sector on the RPI-X@20 Project.
6.69 Of primary concern is to establish a system that properly protects the interests of passengers. The proposed primary duty addresses this point specifically to ensure the CAA’s regulatory decisions will be based on what the CAA believes is in passengers’ best interests and the DfT believes that the appeals mechanism also needs to expressly support this. Under the “standard” model, passengers’ interests will be properly and adequately protected by the CAA’s powers being exercised in accordance with the primary duty. The DfT is however concerned to ensure that the importance of the interest of passengers is reflected more directly in the appeals process and the DfT has also noted the many comments, particularly from airlines, which emphasise that an appeal system will be improved if the regulator has to take account of the possibility of appeal by the airport operator and parties representing passengers’ interests. This symmetrical right to challenge proposed licence modifications (including decisions on price regulation and service quality) appears to the DfT to be likely to enhance regulatory decision taking and the balancing of interests provided the system overall remains proportionate and efficient. The DfT therefore supports the express right for passengers to have a voice in the appeal process but recognises that in practice, it is unlikely that individual passengers will have the resources or expertise to challenge the CAA’s decisions. Indeed providing individual passengers with the right to appeal would also appear to be undesirable in a balanced and proportionate system. **The Government has therefore decided that a designated passenger body, Passenger Focus, should be given the right to appeal licence modification decisions. This right will extend to challenging modifications otherwise agreed between the regulator and the airport company and modifications otherwise agreed through the collective licence modification process.** As indicated above, this is consistent with many comments made by respondents and is a position supported by the Competition Commission and members of the Expert Panel. It is the DfT’s view that a system which allows the airport operator together with a passenger body to have a right of appeal will provide a robust symmetric system encouraging sufficient discipline to the CAA in its decision making. It will be important in this regard to ensure that Passenger Focus as the passenger representative body is sufficiently resourced to carry out this role effectively.

6.70 In the light of the Government’s proposal to allow Passenger Focus standing to appeal, the DfT has also considered carefully the arguments put forward as to whether airlines and other affected parties should also have the right to appeal licence modification decisions, and whether extending the right of appeal to those parties would deliver additional benefits over and above those benefits relating to the decision to allow Passenger Focus standing.
One argument put forward by respondents in favour of extending appeal rights to airlines and others affected reflected the wish for a symmetric system of appeal and this should be addressed by the decision to give standing to Passenger Focus.

The Competition Commission also suggested that the wish for accountability should tend to a presumption of standing for those affected. Whilst a presumption in favour of wider rights of standing appears attractive, it needs to be balanced against any perceived risks in substantially extending the category of potential appellant. This risk was highlighted by a number of respondents although as noted elsewhere in this Chapter, some airlines expressly commented that this risk was, in their view exaggerated. These respondents pointed to the experience in other regimes as evidence that wider rights have not in practice led to a plethora of appeals and undesirable inefficiencies for the system overall. The DfT has considered the evidence in these other sectors. Whilst finding the evidence of some assistance, the DfT is not persuaded that these sectors are directly comparable and relevant to the new regime. In particular, whilst the experiences under the Energy Code and in the OFCOM regime do not indicate a large number of appeals brought by a wider category of appellant, the nature of the decisions under those regimes is narrower than, for example, a decision on price regulation affecting the operation of an entire airport and it may be expected that an appeal in the latter case is more likely. We would also note that appeals under these regimes are adjudicative not investigative.

The DfT was also referred by respondents to the evidence of the lack of claims brought under the existing Section 41 of the Airports Act. Again, whilst this has been useful, the DfT does note that this process is essentially a complaints process rather than an appeals process so is of less direct relevance and the DfT further notes that the lack of claims brought may, at least in part, be due to the availability of alternative routes of complaint, most notably in recent years the Competition Act prohibitions.

In considering whether rights of appeal to licence modifications should be further extended, the DfT has also taken account of respondents’ comments that the balance and proportionality of the framework is affected not only by the parties which have rights to appeal, but also by the nature of the appeal. The DfT notes and agrees that the risks or perceived risks in widening the right to appeal licence modifications to all parties affected by a decision may be reduced if the appeal process is conducted on a narrower basis. The DfT has therefore considered whether the nature of the appeal can be developed: (i) to alleviate concerns about the number and possibly undue regulatory inefficiency of the appeals process; and (ii) which effectively and reasonably constrains the risk of unmeritorious and/or vexatious or frivolous appeals. A number of respondents commented on this, and these issues are discussed in further detail in the final section of this Chapter. The conclusions drawn from this analysis have suggested that for licence modifications, in particular for decisions relating to price regulation and service quality, it is necessary for the appeal process to be

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55 See further comments in the final section of this Chapter.
essentially investigative, rather than adjudicative, in nature. This will be a wider, potentially more wide ranging process than may occur under an adjudicative system, placing a high burden on the regulated company and is a system which will enable the appellate body to gather information from all interested parties including airlines and others affected. The DfT notes that the Expert Panel is strongly supportive of an investigative process for licence modifications. The DfT is also aware of the view of the Expert Panel that there would be significant costs associated with wider rights of appeal and that wider rights would lead to an inefficient regulatory process.

6.75 Drawing all of these related strands together, the DfT is aware that the decision whether to allow rights of appeal for licence modifications to parties other than the airport operator and Passenger Focus is a finely balanced one and that not only are there strong differences in view but that the evidence is not conclusive either way. The DfT is strongly of the opinion that the airlines and other parties affected by a licence modification decision have an important and legitimate role in the licence modification process and the DfT’s proposals for the new framework should reflect this. The interests of airlines are consequently proposed to be taken into account in a number of ways under the new legislative framework. The DfT notes that in many instances the interests of airlines and passengers are aligned and the proposed primary duty towards protecting the interests of passengers will provide significant protection for airlines that their collective interests have been properly taken into account by the regulator. This is explicitly supported by the supplementary duty requiring consultation with airlines and by providing Passenger Focus with standing to appeal licence modification decisions. The DfT is also concerned to ensure that the views of airlines are specifically embedded in the procedures to be adopted by the CAA, and the DfT is therefore endorsing the following proposals which will enable airlines and other affected parties to participate actively in the CAA’s licence modification decisions:

- The process for licence modification should be set out in legislation and require the CAA to consult fully in accordance with and consistent with its statutory duties. The process should require the regulator to engage in discussion with all parties affected (including the airport operator, airlines and passenger groups), and ensure that the Secretary of State is made aware of proposed modifications;
- the CAA should be able to obtain, and provide to all parties with an interest information sufficient to enable them to make informed contributions to any discussion/negotiation and to assess the merit of any proposed decision;\(^\text{56}\)
- in relation to proposed licence modifications the process should require the CAA to publish a proposed determination and for affected parties to have a further opportunity to comment following publication but before a final determination is made by the CAA; and

\(^{56}\) The precise nature of this information and any confidentiality issues related to its disclosure and subsequent dissemination and use will need to be considered in detail.
following publication of the CAA’s final determination on any proposed licence modification including on price or service quality matters, Passenger Focus as well as the Secretary of State and the airport operator should have the right to require that the matter is referred to the Competition Commission for determination.

6.76 The issue is, however, whether there are additional benefits in extending appeal rights to airlines and others affected and whether the benefits of doing so outweigh the risks and therefore justify extending the new framework even further beyond the “standard” model under which appeal rights are restricted to the regulated company only. On this question, the evidence appears to the DfT to be inconclusive. There is evidence and comment as discussed above which indicates the extension of appeal rights may not lead to an inefficient regulatory framework or an undesirably high level of challenge to the regulator’s decisions. Other evidence and comment suggests however that this is a legitimate concern and one which cannot be alleviated by adopting a narrower adjudicative basis of appeal. On balance, the DfT is of the view that the “standard” model has delivered reasonable regulatory outcomes in other regulated regimes but that these outcomes are likely to be improved in a symmetric system in which Passenger Focus has standing in addition to the regulated company. The DfT is not however satisfied that the case has yet been sufficiently made out that the benefits of extending appeal rights beyond Passenger Focus outweigh the risks that wider appeal rights will lead to undue regulatory uncertainty and inefficiency and undermine the role of the CAA as the primary regulator in the sector.

6.77 The DfT has further considered the responses received in relation to Option 2. The DfT notes that there was very little support for Option 2 and that there were a number of concerns raised in relation to it. The DfT is therefore not proposing to pursue Option 2 as a solution to this issue.

6.78 As a consequence of the responses received and the analysis summarised above, the Government has decided that the right to appeal licence modification decisions including those related to price regulation and service quality will not be extended to airlines or other parties who may be affected by the decisions.

6.79 The section below analyses in more detail issues concerning the precise procedure to apply in any appeal of licence modification decisions. On the basis of this analysis, the Government has decided that the appeal mechanism for challenging licence modification decisions should be based on the investigative procedures applied in other regulated sectors for the appeal of licence modification decisions and that in general it should be based on an assessment of whether the matter referred operates or may be expected to operate against the public interest. The public interest will be defined with reference to the CAA’s statutory duties.
Process for appeals

Government proposals

6.80 In the consultation, the DfT did not provide detailed comments or proposals on the precise form of appeal that might be provided for in relation to any challenge to CAA decisions. The DfT commented on the limitations of judicial review and suggested proposals for merits based appeals. This terminology distinguished an appeal where the merits of a decision are considered, from an appeal which is considered only if the CAA had followed proper procedures. The DfT did not, however, comment in the consultation on precisely what might be meant by a merits based appeal and in particular did not comment on the approach required to be taken by the appellate body in such an appeal.

6.81 In the consultation, the DfT did nevertheless recognise that it will be important, if the right of appeal is extended to other parties, to have appropriate provisions in place to deter frivolous or vexatious appeals and noted that there is a general consensus that whichever system is adopted it needs to control the risk of “excessive” appealing and/or vexatious/frivolous appeals.57

Consultation responses

6.82 Many respondents did not comment on the exact nature of any appeal, whilst most approved the general proposal that appeals should be on the merits of the decision. The Competition Commission and the CAA did analyse the nature of the appeal and their comments have been referred to in detail above. The distinction drawn by the Competition Commission between an investigative appeal and an adjudicative appeal was of particular assistance.

6.83 The Competition Commission noted that there is a broad consensus which the Competition Commission supports, that an appeal relating to price control should be against the merit of the regulator’s decision i.e. that the appellant can ask the appeal body to engage with the substance of the issue. The Competition Commission regards an appeal on the merits as essential given the complexity of the subject matter and given that even under the current system an independent body, the Competition Commission, assesses the merits of the price control proposals and makes public interest determinations. In the Competition Commission’s view, judicial review would not be an adequate safeguard and would diminish the intensity of scrutiny in the system. This view led the Competition Commission to consider whether the Competition Commission as the appeal body should act in its normal investigatory role or in the adjudicative role that it has recently assumed in relation to the regulation of some parts of the energy and telecommunications sectors.

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57 See paragraph 8.9 of the Consultation.
The CAA supported the reform of the current system of appeals but emphasised that the new system needs to avoid replacing the current system with a system which subjects regulatory decisions to near automatic reassessment by the appeal body. The CAA said that a merits based appeal, such as one limited to determining if their decision was reasonable, would afford the regulator an appropriate level of discretion as to how to translate its statutory duties into detailed proposals. Such an approach would also give a clearer notion of whether an appeal was successful and therefore enable the system to reduce the risk of vexatious appeals through the risk of costs awarded against the appellant.

The vast majority of respondents expressly recognised the risk that the appeals system could lead to numerous appeals, unmeritorious appeals and frivolous or vexatious appeals and that the framework should be designed to reduce this risk. The risk is accepted to be greater the wider the category of permitted appellant.

Whilst recognising those concerns, BA and Virgin believe that this risk is in fact exaggerated. BA pointed to the following evidence in support of this view: including that to date wide ranging rights have existed with respect to Section 41 Airports Act powers but airlines have brought very few cases to the CAA and have not used this provision unreasonably; broader stakeholders have the right to appeal OFCOM decisions but this has not been a problem in practice or a hurdle to effective decision making; and the right of stakeholders to appeal code modifications in the energy sector has not led to a plethora of appeals – in fact only two.

BA believes the evidence suggests that stakeholders other than the regulated company only use their appeal rights when appropriate and BA believes this is impacted by the time commitment required of senior management, the external costs of an appeal and an initial stage of establishing the right to appeal stopping vexatious or frivolous appeals or appeals based on insufficient evidence. Virgin does not believe that the expressed concerns will manifest themselves in reality. It believes costs for parties undertaking appeals individually or collectively are a deterrent, both in terms of legal fees and internal manpower.

There is, nevertheless, a general acceptance that the system will need to be designed to control the number and quality of appeals. The Competition Commission commented that some of the perceived difficulties arising from generous rights of standing can be alleviated in an adjudicative system specifically through the power to award costs and the power to filter out unmeritorious claims at a permission stage.

A number of respondents made comments on how vexatious appeals could be controlled/managed arguing that an appeal mechanism could be based on the following:

- The appeal body could be given powers to prevent vexatious appeals based on the information requirements of appeal mechanisms already in existence. For example under a section 41 of the Airports Act 1986 or Chapter 2 of the Competition Act 1998 complaint, currently there are guidelines regarding the process and information that the complainant needs to bring forward;
6. Enhancing accountability

- the appeals process could include various stages to ensure that frivolous appeals are rejected. For example, the CAA’s current procedure for dealing with Section 41 cases has four stages; and
- the appeal body could be permitted to allocate costs to those appeals seen to be wholly without merit.

6.90 A number of parties expressly commented that costs awards will act as a balance against frivolous/unmeritorious appeals.

6.91 easyJet believes that to deter vexatious appeals the appeal body should be able to reject appeals not backed up by sufficient evidence and where the party did not take part in consultations.

6.92 The Competition Commission recommended that appeals should lie to the Competition Commission against the merit of the regulator’s decision but did not specifically recommend that either an investigatory or adjudicative role should be adopted. The Competition Commission commented that in either case it can bring its expertise to bear quickly with no delay between initiation of the appeal and the Competition Commission’s engagement with the substance. The Competition Commission also proposed that even if there is an adjudicative system the regulated airport might wish the Competition Commission to carry out an investigation and review the entirety of a price control determination and this may be a useful adjunct to an essentially adjudicative system if the regulated airport is given such a right. The Competition Commission also addressed whether there is a risk that the Competition Commission will effectively become the regulator of the system. The Competition Commission stated that this concern was addressed when the Energy Code Modification appeal system was created under the Energy Act 2004. In that case the wish was to promote regulatory accountability while avoiding the creation of a second tier regulator. The adjudicative approach adopted under the Energy Act 2004, in which the Competition Commission allows an appeal where it is satisfied the appellant has shown that the regulator has gone wrong is, in the Competition Commission’s view, a less intrusive role for the Competition Commission than its more traditional investigative role.

6.93 The CAA did not express a specific preference on the form of appeal against licence modification decisions but commented on the options put forward by the DfT in the Consultation. In relation to Option 1, which provides for wide rights of appeal on all licence modification decisions to all affected parties, the CAA recognised that this exposes the regulator’s decisions to the greatest degree of scrutiny but provides the lowest degree of discretion to the regulator. The CAA is concerned that this would undermine timely and efficient decision making, particularly if the appeal takes the form of a referral of the decision to another body for a new assessment on first principles. The CAA noted that with this type of appeal it would be difficult to identify winners and losers and award costs, and without a costs award it would be difficult to deter appeals effectively. The CAA would be more accepting of Option 1 if what it calls a merits based appeals process was adopted (this is what the Competition Commission refers to as an adjudicative appeal). Under this approach the decisions could be challenged, but the appeal body would consider whether the...
CAA’s decision was right on its merits judged against a specified test. This
test might be, for example, and as the CAA has suggested, whether the
CAA’s decision was reasonably measured against the regulator’s statutory
duties. Whatever the precise test adopted, it should be noted that it would
not be the appeal body making a new decision to replace the original
decision of the regulator, nor would it be the appeal body deciding if it
would have made the same decision. The CAA sees this type of appeal
as lending itself to winners and losers and having the ability for the appeal
body to award costs as a result.

**Government’s decision**

6.94 The responses to the consultation indicate a general acceptance that the
system needs to be designed to control the number and quality of appeals
including the risk of frivolous and vexatious appeals. The responses also
indicate an acceptance that the nature of the appeal process is directly
relevant to a consideration of which parties have standing to appeal. The
Competition Commission, for example, noted that some of the perceived
difficulties arising from generous rights of standing can to an extent be
alleviated more easily in an adjudicative system including through the use of
costs awards and the power to filter out unmeritorious appeals.

6.95 The DfT has therefore as part of its analysis considered a number of
adjudicative systems including the systems under the Energy Code and
the Telecoms Code, as well as the general right of appeal allowed to
parties in relation to the appeal of High Court decisions.\(^5\) As a result of the
above analysis and the responses to the consultation, it is the DfT’s view
that in either an investigative or adjudicative system the risk of vexatious
or frivolous appeals, or appeals which have no reasonable prospect of
success, can, to varying degrees be controlled through a permission stage
(or a power to strike out) and can be supported by the power to award
costs both in relation to the appellate body’s costs and those of other
participants. It is recognised that in practice, these filters and controls will
be more effective in an adjudicative rather than an investigative system but
it is the DfT’s view that they have benefit in both. The detailed procedures
under which the appeals are heard can also effectively identify the relevant
points in issue and can be used to ensure the efficient resolution of the
appeal once brought. The detailed procedures under which the Competition
Commission and CAT will hear appeals in the new framework for airports
will be determined in due course but we would note that their respective
existing general procedures, as well as the specific rules developed for
the Telecoms regime and the Energy Code, as well as the CAT’s rules for
proceedings before the CAT, all support the ability of appellate bodies to
regulate and prosecute appeals efficiently once brought. However, these
procedures will not in practice be particularly effective to filter investigative
appeals at an early stage as it will, in most cases, not be easy to determine
whether an appeal is vexatious or frivolous or has no reasonable prospect
of success. The DfT therefore disagrees with the Competition Commission

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\(^5\) The DfT has also considered the current Section 41 Airports Act procedures (which it notes is not in fact an appeals
process though the procedures do have relevant points of interest) and the procedures for appeal of a regulator’s
decision to impose a penalty.
that all issues of this nature should be addressed through process and not standing.

6.96 The DfT’s analysis also strongly suggests that it is not practical to establish an effective adjudicative system to review price regulation or service quality decisions at airports. In relation to airports, such decisions are made by the regulator having considered a large number of inputs and having balanced many different considerations. These decisions do not, in the DfT’s view, lend themselves to challenge on a narrow adjudicative basis. Whilst the Energy Code process is an essentially adjudicative model, and appears to be a robust and appropriate process in its context, it does not consider the total costs of the regulated company and the grounds of challenge in that specific context can be limited and defined within an adjudicative framework. Similarly the Telecoms Code, whilst an adjudicative process under which price control matters are referred to the Competition Commission for determination, is not a directly applicable equivalent as decisions concern only part of the regulated company’s costs and not the totality of the regulated company’s costs and pricing basis. It is also worth noting that the experience of the Telecoms Code appeals suggests that the price control appeals in practice have investigatory elements to them. This analysis is strongly supported by the Expert Panel. **The Government has therefore decided that appeals of licence modifications, including those relating to price regulation and service quality should be determined on an investigative basis.** It is the DfT’s view that the investigative process standard across other regulated sectors in the UK for licence modifications would be an appropriate model upon which to design the framework for the new airports regime.

6.97 This conclusion on the appropriate type of appeal, together with the DfT’s wish for the CAA to maintain its role as the primary regulator in the sector, and the DfT’s assessment of how airlines and other affected parties interests are properly taken into account in other aspects of the framework, has supported the decision that the appeal of licence modifications should be available to the airport operator, the Secretary of State and Passenger Focus only.

6.98 In relation to Tier 1 decisions, the DfT’s analysis of procedures indicates that either an investigative or adjudicative process could be effectively adopted. The issue is likely to be one of assessing market power for which investigatory processes may be appropriate. Conversely, the points in issue are likely to be capable of narrow identification for which an adjudicative process would be effective. It is the DfT’s view that the appeal process should where possible support the CAA as the primary regulator and therefore, on balance **the DfT has decided that Tier 1 decisions, where standing is being given to all parties with a material interest, should be subject to an adjudicative basis of appeal.** Whilst detailed procedures for such appeals will be determined and established in due course, particular features of the appeal system should in the DfT’s opinion include:
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- a stage which would enable appeals which were frivolous or vexatious or otherwise with no reasonable prospect of success to be filtered out either through a permission stage or through a power to strike out;
- clear procedures to enable the CAT to define the points at issue and to direct the progress of the appeal in a timely and efficient manner;
- the power of the CAT to award costs against any party in relation to the CAT's own costs and those of any other party;
- the appeal decision to be made by the CAT on its merits;
- the precise test for the appeal is to be considered further but it is likely to be on whether the original decision of the CAA was wrong in law or fact or based on the wrong exercise of discretion. The CAA supported the reform of the current system of appeals but emphasised that the new system needs to avoid replacing the current system with a system which subjects regulatory decisions to near automatic reassessment by the appeal body. A merits based appeal, such as one limited to determining if the CAA decision was reasonable, would give a clearer notion whether an appeal was successful and reduce the risk of vexatious appeals through cost awards; and
- if the original decision was found to be wrong, the issue would be referred back to the CAA and the CAT would have the power to give directions in that regard.

CAA annual report and accounts

6.99 The consultation indicated that as part of implementing the Pilling review conclusions, changes would be made to the governance of the CAA. The appointment of a new Chairman and Chief Executive earlier this year are part of these changes. Consistent with good regulatory practice in other sectors we will ensure that the CAA continues to provide information about the exercise of its economic regulation functions in its key corporate publications, specifically to:

- Include in its annual report an explanation of the work it has undertaken during the year. This report is laid before Parliament, and it would be open for Committees of Parliament to question the CAA about its contents.
- Include in its accounts information to show how it has spent the licence fees it will receive to fund its economic regulation functions for airports. We recognise that this information will need to be consistent with the wider accounts of the CAA, and include appropriate allocation of costs where staff and resources are used for functions outside the CAA's economic regulation of airports.
- Include information in its corporate plan about key planned activities and work areas. This plan should cover the next five years, while recognising that more detail about the CAA's planned activities would be provided for the next one to two years, than for the later years of the period.
6.100 We consider that these proposals are consistent with regulatory good practice and have been widely adopted in other sectors subject to economic regulation.

Summary of key decisions

6.101 In this chapter we have proposed that:

- The CAT should be the body that considers appeals regarding Tier 1 licence decisions, and the appeal should be an adjudicative appeal. The licence holder or potential licence holders and all other parties with a material interest (which will be determined by the CAT) should have a right to appeal. The Secretary of State will also have a right to refer a Tier 1 decision to the CAT.

- Licence modification determinations by the CAA will be subject to a right of appeal to the Competition Commission by way of an investigative procedure. Licence holders, as well as the Secretary of State and Passenger Focus as the passenger representative body for passengers’ interests, will have the right to challenge CAA proposed licence modifications and determinations.

- Various aspects of current good practice from other appeal processes should be adopted for these appeals.

- The CAA will be required like most other economic regulators to include relevant information in its annual report, annual accounts, and its forward-looking corporate plan.
7. Enhancing passenger representation within the aviation sector

Introduction

7.1 The reforms to the regulatory framework for airport economic regulation, including placing a primary duty on the regulator to further the interests of passengers and the introduction of a more flexible licence-based approach to regulation that can be tailored to individual airports, provides the regulator with a clearly defined objective and the appropriate regulatory tools to achieve it. But in order to truly put the passenger at the heart of the new regulatory regime the regulator needs to understand the passenger experience and the improvements to this which are demanded by passengers.

7.2 There are four complementary pillars within the new framework for airport economic regulation which we believe, taken together, will ensure the Civil Aviation Authority (CAA) understands the passenger experience and can therefore take actions consistent with its primary duty to promote their interests. Firstly, there will be authoritative, powerful and independent passenger representation. Secondly, the CAA is further developing its internal consumer policy perspectives and the new regulatory framework, in particular the primary duty to passengers, will build on this progress by further developing the CAA into a consumer-focused regulator whose approach is based on the experiences and needs of air passengers. Thirdly, the passenger representation body will have rights to appeal the CAA's regulatory decisions on which airports should have a Tier 1 licence and the subsequent licence modification that should be imposed on such airports should help ensure that passengers' views are more fully embedded into the decision making process. Finally, the regulator will have a supplementary duty to consult with stakeholders, including airlines. As discussed more fully in chapter 3, airlines will be capable of representing passenger interests in many cases and they will also be able to provide information about airport activities that passengers do not directly observe (but which affect the passenger experience).

7.3 This chapter focuses on the first pillar described above: establishing authoritative, powerful and independent passenger representation in the aviation sector. In the remaining sections of this chapter we:

- Explain the current arrangements for passenger representation in the aviation sector;
7. Enhancing passenger representation within the aviation sector

- discuss the requirements for enhanced passenger representation in this sector;
- explain the proposals for reforming passenger representation on which we consulted;
- summarise consultation responses received; and
- explain our decision on how to enhance passenger representation in the aviation sector.

Existing arrangements for passenger representation

7.4 Under existing arrangements, the Air Transport Users Council (AUC) represents the interests of users of air transport.\(^{59}\) Set up in the 1970’s by the CAA, its main focus has been on airline issues rather than those relating to airports or other stages of the wider end-to-end journey. There are a number of reasons for this. Firstly, the AUC is funded through the CAA by airlines. Secondly, its memorandum of understanding with the CAA generally limits its activities to issues falling outside the CAA’s regulatory remit, and thirdly, since 2004 the AUC’s workload has been dominated by complaint handling following the introduction of an EU Regulation enhancing the legal rights of air passengers, in particular with regards to denied boarding, cancellation and delays. For these reasons the AUC has been unable to commit many resources to the establishment of dedicated passenger advocacy functions or to influencing the passenger’s experience at airports.

7.5 As mentioned above, the AUC’s main focus has been on airlines. In relation to airports, Airport Consultative Committees would appear to be the only bodies where the interests of passengers are represented. These Committees, which are funded by the airports and local authorities, tend to focus on local community issues, but some of the larger airports have set up sub groups that focus on consumer and passenger issues.

7.6 The future role of the AUC was considered by Sir Joseph Pilling in 2008 as part of the independent Strategic Review of the CAA conducted for the Secretary of State. Sir Joseph Pilling recommended that the AUC should be put on a statutory footing and that whilst it should retain its complaints-handling role more weight should be given to a consumer advocacy function.\(^{60}\)

7.7 The Consultation document also noted that the CAA had recently taken steps to further develop its internal consumer policy role. Building on recommendations that came out of the Pilling report, the CAA has proposed a number of initiatives to strengthen its consumer policy function and consumer representation in air travel. Further details on these proposals

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\(^{59}\) The Consumer Council for Northern Ireland has statutory responsibility to protect and promote the interests of passengers travelling to, from and within Northern Ireland.

\(^{60}\) In addition, Sir Joseph Pilling also recommended that the AUC’s Chair and members should be appointed by the Secretary of State, that it should be physically separated from the CAA to reinforce its independence and that the CAA should set the budget for the AUC in response to business plans, but the AUC should have a right of appeal (and produce accounts).
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can be found in the consultation document.\textsuperscript{61} In addition to this, the Government is currently consulting separately on other proposals to update the CAA’s regulatory framework. These include the Government’s proposal to give the CAA new general objectives to ensure that the CAA can fully uphold the public’s interest in aviation when carrying out its regulatory functions. Subject to consultation responses, we presently expect these objectives will apply across the organisation where possible and appropriate (although they would not apply to the CAA’s airport economic regulation functions – see chapter 3 above) and include one which would require the CAA to pursue the reasonable interests of consumers. Taken together, we believe the proposed general consumer objective and the primary airport economic regulation consumer duty will help the CAA to deliver a consumer focused strategy going forward.

Requirements for effective passenger representation within the aviation sector

7.8 As part of the review of airport economic regulation and in light of the Pilling report, the DfT and the Expert Panel gave considerable thought to the requirements for effective and influential passenger representation in the aviation sector. As a result, the consultation document proposed that the institutional arrangements for measures to improve the passenger experience should reflect the following principles:

- There should be an independent advocacy function, covering both airport and airline related issues, which has authority and credibility with government, the CAA, the industry and the public. This should be able to tackle a wide range of issues, including at European and international level, and have the skills and knowledge to be able to provide input to regulatory strategies and decisions, including decisions on price regulation.

- Complaints handling should be conducted by a body which has legitimacy and visibility, and with the expertise to engage effectively with airport operators and airlines. The information gathered should form an important, but not the only, input into the policy advocacy function.

- Consumer policy perspectives – including the interests of freight users as well as passengers – should be well reflected within the CAA’s organisational culture enabling the regulator to develop a greater ‘feel’ for the passenger experience over time.

7.9 In order to gain a more in-depth and qualitative view about passengers’ experiences, the DfT commissioned a set of focus groups and interviews.\textsuperscript{62} The findings from these focus groups revealed that most passengers view airports as simply one stage of a wider end-to-end journey comprising getting to/from the airport, getting through the airport and flying to/
from their destination. The focus groups also revealed that whilst most air passengers recognised the distinct role of different service providers responsible for delivering the end-to-end journey, especially at the airport, when problems did arise there appears to be no focal point with overall responsibility to resolve complaints effectively.

7.10 The findings of these focus groups indicate that arrangements to represent the interests of passengers would ideally cover both airline and airport issues and, as far as is possible, each stage of the end-to-end journey.

**Reforming passenger representation within the aviation sector**

7.11 Building on Pilling’s recommendations and reflecting the need for an independent body to represent the interests of air passengers as part of an integrated transport system within a wider end-to-end journey, the consultation document proposed that Passenger Focus should be given responsibility for air passenger representation with regards to airline and airport issues. Passenger Focus is the statutory body responsible for representing the interests of Britain’s rail passengers. In that role it has established a reputation as an effective passenger champion and is regarded as authoritative and credible by government, the industry and the public. Subject to Parliamentary approval Passenger Focus will start to represent bus, coach and tram passengers in England, outside of London from April 2010.

7.12 The Consultation document noted that some users of airports will use public transport outside Passenger Focus’ overall remit. There are other statutory consumer bodies representing these passengers and the consultation document sought views on how we could maximise the end-to-end approach to airport journeys, without duplicating effort. The consultation document also sought views on the Expert Panel’s suggestion of expanding the use of airport passenger service committees as a means of providing valuable consumer intelligence about issues relating to each airport.

7.13 It was proposed that Passenger Focus’ air passenger representation functions would be industry-funded via the licence fee for administering airports economic regulation. We would expect this additional cost to be reflected in higher airport charges to airlines which in turn, given the broadly competitive nature of the airline market, would pass through to passengers via air fares. This funding arrangement would replace the current funding arrangements for the AUC, for which industry indirectly pays via the CAA and would mirror the arrangement used in most other sectors. The consultation document noted the importance of ensuring that internal arrangements are in place to prevent cross-subsidy where there were a number of different funding streams for different transport modes.

7.14 Finally, we proposed that Passenger Focus would also mediate complaints where the passenger and service provider have been unable to reach agreement. This would include taking on responsibility from the AUC
for complaints handling with regard to the EU Regulation on Denied Boarding and Cancellation (DBC), for which the AUC is currently the legally designated complaints handling body. The information gained through complaint handling can provide a useful (but not the only) source of input into their air passenger representation work and so there are clear advantages in the aviation sector of giving responsibility for both complaints and advocacy to the same body. This would also minimise overhead costs for the aviation-arm of Passenger Focus. We would expect Passenger Focus to draw upon the expertise, knowledge and goodwill built up by the AUC, particularly in relation to EU passenger rights law and therefore proposed that AUC staff should be integrated within Passenger Focus.

7.15 As noted above, the CAA has recently taken steps to improve its consumer policy function to ensure that consumer perspectives are better reflected in all of its policies. We welcome these developments and propose similar funding arrangements to those discussed above in relation to consumer advocacy. The consultation document noted that other economic regulators, such as Ofgem, have found it useful to have a consumer panel acting as a ‘critical friend’ and advisor as it discharges its duties, providing a safe space for ensuring that consumer policy issues are addressed properly. It also noted the Expert Panels’ views that there were clear benefits in Sir Joseph Pilling’s recommendation to merge the Economic Regulation and Consumer Protection Groups within the CAA which, they argue, would further help ensure consumer perspectives are fully integrated within economic regulation. However, these are matters for the CAA to consider further.

7.16 The consultation document put the following questions to stakeholders (questions 10.1 and 10.2):

- Do you agree with the proposal to give Passenger Focus responsibility for consumer policy advocacy with regards to airlines and airports, funded through airport licence fees? In particular, we welcome views on the proposal for Passenger Focus to develop and support a network of consumer panels at leading airports.

- Do you agree with the proposal to give Passenger Focus responsibility for complaints handling on airline and airport issues alongside its policy advocacy function? How can we best ensure the expertise and sector knowledge in relation to EU air passenger rights built up over time by the AUC is retained?

Consultation responses

7.17 Consultation responses supported the idea that there needed to be an effective passenger representation body which should have responsibility for both advocacy and complaints handling. However, while there was general agreement on this high level issue, there was a significant level of discussion about the most appropriate organisation to carry out the passenger representation role and the means of funding such a body. Overall, responses were mixed and where concerns were raised, they tended to fall into one of two broad categories: i) the suitability of one organisation representing passengers across different transport sectors and ii) funding.
Proposal for Passenger Focus to represent passengers’ interests

7.18 A number of airport operators and consumer groups and some stakeholders were supportive of the proposal to give Passenger Focus responsibility for air passenger representation with regards to airline and airport issues. Some responses welcomed Passenger Focus’ approach (which had been demonstrated on rail passenger representation) of working towards improving information on performance and reliability, improving complaints handling systems and ensuring that customer surveys are conducted. Many recognised the benefit of having a joint passenger representative body, in particular the ease of reference for passengers to a more holistic passenger body in transport.

7.19 Other stakeholders (Co-operative travel, Manchester Airports Group and Virgin Atlantic) were supportive of the creation of an independent passenger representation body but did not have a particular opinion about whether this role should be carried out by the existing Air Transport Users Council or Passenger Focus.

7.20 A number of respondents were not supportive of the proposal to have air passengers represented by Passenger Focus – the airlines, their representatives and the airport consultative committees tended to be in this group (as well as the Association of British Travel Agents (ABTA) and the AUC itself). These responses were often not convinced that there was a synergy between Passenger Focus’ current role and that of representing air passengers. They felt that air transport was a complex industry with a larger number of players and different skills in representation and advocacy would be required as compared to those for rail or bus. The AUC and others stated in their consultation response that the vast majority of air passengers currently travel to airports by car and that at the London airports, where public transport usage is highest, passenger representation is largely undertaken by London TravelWatch63 – thereby undermining the integration argument for appointing Passenger Focus.

7.21 The responses that were not supportive of the proposal generally put forward one of two options: A greater role for the AUC (in line with the Pilling recommendation), and/or a more formal role for the existing airport consultative committees.

7.22 A number of responses said they would like to see more use made of the existing airport consultative committees as well as the sub committees focusing on passenger service issues, which are in operation at some of the larger airports, and there was some concern that the development of a network of consumer panels would potentially duplicate the work of these committees. Consumer Focus was not convinced that airport consultative committees provided the right forum as these were viewed as having very limited passenger representation and as focusing on local community engagement.

63 London Travelwatch is officially known as the London Transport Users’ Committee
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7.23 Other responses expressed the need for Passenger Focus to maintain, clarify or develop relationships with other bodies including: the Consumer Council for Northern Ireland; the CAA; Airport Consultative Committees; and London TravelWatch. The Scottish Government wanted to maintain the existing Scottish representation, with at least one member of the board being based in Scotland and understanding the particular nature of aviation in Scotland and the Consumer Council for Northern Ireland noted that it has statutory responsibility to represent passengers in Northern Ireland so Passenger Focus’ scope would be limited to Great Britain.

Proposal to fund passenger representation via the licence fee

7.24 Support for the proposal that air passenger representation would be industry-funded via the licence fee for administering airports regulation was primarily limited to consumer bodies. Which? noted that funding the passenger advocate through the airport licence fee would be consistent with arrangements in other regulated sectors. Consumer Focus also suggested that funding could be through the rebates which arise when airports underperform.

7.25 Of those responses that objected to the use of airport licence fees to fund a passenger representation body for air passengers, two main concerns were expressed. The first concern – that the higher licence fee would be passed on to customers in the form of more expensive airfares – was expressed by the Trading Standards Institute, local authorities and some travel agents. The second concern was the potential mismatch between the different funding arrangements for Passenger Focus’ work. More specifically, Passenger Focus’ current functions are funded by the Government, whilst the proposal is for air passenger representation to be funded through licence fees. Concerns about the separation of funds, the need for ring-fencing and a potential conflict of interest between rail and short haul air travel that might arise from the separate funding arrangements were expressed by the airlines, the Airport Consultative Committees and the AUC.

7.26 Passenger Focus felt that it could deal with the different funding arrangements and noted that it currently manages funding from two parts of the DfT. It also expressed the view that it could call on the experience of Consumer Focus and others in handling more than one stream of funding. Passenger Focus felt that an effective and transparent business planning process combined with an effective audit function would help to ensure that money allocated to air passenger activities could be ring-fenced.

7.27 There were other funding-related concerns raised in the responses. In particular, the Consumer Council for Northern Ireland wanted to ensure that any fees collected through Northern Ireland airports were retained to support consumer representation in Northern Ireland. Manchester Airport Group noted its view that the licence fee needed to be applied to a wider range of airports than just Tier 1 and Tier 2 airports given that some airports falling into Tier 3 are still quite large.
Government's decision

7.28 We continue to believe that there needs to be an effective passenger representation body, which should have responsibility for both passenger advocacy and complaints handling and confirm that the geographical scope of this body would exclude Northern Ireland, which means that any airport operators with tier 1 or tier 2 licences in Northern Ireland would not contribute to the funding of such a body. We do not believe that stakeholder responses have raised any issues that undermine the viability of our original proposal – that Passenger Focus should represent the interests of air passengers and that this should be funded via the airport licence fee. As mentioned above, where stakeholders were not supportive of our proposals, the concerns tended to fall into one of two broad categories: i) the suitability of one organisation representing passengers across different transport sectors and ii) funding. We deal with each of these concerns in turn below.

7.29 Some stakeholders noted that there were some fundamental differences between the aviation sector and other transport sectors which would require different skills for representation and advocacy. Passenger Focus currently represents passengers in the complex rail industry and is currently preparing for its role in the bus sector. We believe there is no reason to suggest that Passenger Focus would be unable to take on a similar role in another sector – namely air travel – as it has well established effective passenger advocacy skills and will already be representing two quite different transport sectors. We acknowledge that it would need to develop sector specific knowledge and we expect Passenger Focus to acquire quickly the necessary knowledge, ensuring that the expertise and experience built up within the AUC is maintained in Passenger Focus.

7.30 Government policy has generally been to reduce the number of sector specific consumer representation bodies and move towards multi-sector consumer bodies, which can bring a broader perspective. The fact that different transport industries have different characteristics does not necessarily affect the focus of the passenger representative body – which is to improve the passenger experience. Provided Passenger Focus takes account of the sector differences through acquiring the relevant knowledge and adapting its approach to understand the issues affecting passengers it represents, multi-sector organisations offer many advantages over single sector bodies, not least the breadth of experience, ability to make comparisons and consumer advocacy expertise necessary for strong, effective consumer representation. As mentioned above, due to resource constraints, the AUC has been unable to develop much dedicated passenger advocacy expertise or influence the passenger experience at airports to date.

7.31 Other responses were not convinced that Passenger Focus could provide a more end-to-end journey approach to passenger representation. They noted that the vast majority of air passengers currently travel to airports by car and that at the London airports, where public transport usage is highest, passenger representation is largely undertaken by London TravelWatch.
7.32 As highlighted above, the findings of the passenger focus groups indicate that arrangements to represent the interests of passengers would ideally cover as far as is possible, each stage of the end-to-end journey. We continue to believe that Passenger Focus will be able to represent a far greater number of end-to-end journeys than any other representative body. We expect Passenger Focus’ remit to cover the airport boundary and note the work it has already done on station car parks as part of its role in the rail sector.\(^{64}\) As a result, we believe that Passenger Focus will be able to adopt a more integrated approach to representing the interests of passengers who drive to airports. Passenger Focus’ remit encompasses rail in London and we understand that Passenger Focus and London TravelWatch have developed a good working relationship, with London TravelWatch already represented on Passenger Focus’ Council (commonly referred to as its Board). We also note that Passenger Focus already publishes data on rail access via the Gatwick, Stansted and Heathrow Express. As a result, we believe it should be able to take a more integrated approach to representing the interests of passengers who use public transport in London to get to the airport.

7.33 In relation to funding Passenger Focus’ air passenger representation functions via the licence fee for administering airports regulation, two main concerns were raised. The first concern was that the higher licence fee would be passed on to customers in the form of more expensive airfares. As mentioned above, passenger representation is currently limited to airline issues and focuses on complaint handling; the AUC has not had the resources to establish dedicated advocacy skills or influence the passenger experience at airports. In order to put in place arrangements for more powerful and effective passenger representation, which will ensure that the passenger experience is at the heart of new regulatory regime, some additional funding will therefore be required. This would be reflected in higher airport charges to airlines which in turn, given the broadly competitive nature of the airline market, should pass through to passengers via air fares.

7.34 However it is important to put the increased costs associated with powerful and effective passenger representation in context; even if we include the costs associated with the CAA further developing its internal consumer policy perspective, the cost of passenger representation will amount to no more than a few pence per passenger per year. This compares favourably to other consumer representation bodies. For example, the Consumer Council for Water costs 25 pence per year for each water bill payer.

7.35 The second concern was the potential mismatch between the different funding arrangements for Passenger Focus’ work. As is the case in the water, energy and postal sectors, passenger representation in the aviation sector has always been industry funded and we see no good reason to adopt a different approach. The advantage with funding air passenger representation via the licence fee is that it would be only the users of licensed airports who would pay.\(^{65}\)

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\(^{64}\) More information on this work “Getting to the station” is available at the following link http://www.passengerfocus.org.uk/news-and-publications/document-search/document.asp?dsid=934

\(^{65}\) We understand the licenced airports handle around 90% of total passenger numbers.
7. Enhancing passenger representation within the aviation sector

7.36 Concerns were also raised about the need for ring-fencing. The Government agrees that the aviation industry should only pay for air passenger representation and that there is a need to ensure that no cross subsidy occurs towards the work of Passenger Focus on bus and rail. The Government will ensure that Passenger Focus sets up transparent funding mechanisms so that: i) air passengers do not pay for advocacy that does not benefit them; and ii) air passengers contribute a fair share of Passenger Focus’ corporate overheads.

7.37 Some respondents feared that Passenger Focus will inherently have a rail bias, but the Government does not believe this will be the case once Passenger Focus has a statutory remit to represent air passengers. In addition, we are not persuaded that separate funding arrangements give rise to any material conflict of interest in this context. We will be consulting on Passenger Focus’ specific duties and powers in relation to air passengers, which will be subsequently defined, possibly in secondary legislation. If there are competing demands in the different sectors it represents, Passenger Focus would be required to make a reasoned judgement in line with its statutory duties. The benefit of having a passenger representative with statutory remits covering rail, bus and air passengers is that its perspective will more closely mirror that of the passenger’s – as one, integrated, end-to-end journey.

7.38 Other stakeholder responses highlighted the need for Passenger Focus to maintain, clarify or develop effective relationships with other bodies. We expect Passenger Focus to build appropriate and effective working relationships with relevant organisations in the industries it represents (including, but not limited to the Northern Ireland Consumer Council). The Government will consider the structure of Passenger Focus’s Council (commonly referred to as its Board) to ensure it accurately reflects passenger interests across all transport modes and regions. Passenger Focus already works in a complementary way with the Office of Rail Regulation and the Government envisages that it will support and challenge, without duplication, the work of the CAA with its new enhanced consumer policy role. We would expect Passenger Focus to work with the CAA and to draw up a memorandum of understanding which makes their respective roles transparent. As set out in the Consultation document, we would expect Passenger Focus to draw upon the expertise, knowledge and goodwill built up by the AUC, particularly in relation to EU passenger rights law and therefore propose that AUC staff should be integrated within Passenger Focus.

7.39 Finally, we expect Passenger Focus to build on its regional network of passenger link managers to develop an insight into the passenger experience at airports. It is for Passenger Focus to decide whether or not to establish a network of consumer panels at leading airports but we do not envisage a lesser role for passenger representation by airport consultative committees at airports. It will be for Passenger Focus to determine the best way of drawing on the work of the committees (in particular the sub committees focussing on passenger service issues, which are in operation at some of the larger airports) in order to avoid any duplication of effort. The Department proposes to review the guidance to consultative
committees to reflect the current comprehensive scope of their activities and we will consider how this might be used to facilitate cooperation between the committees and Passenger Focus. For example, we may wish to recommend that Passenger Focus should be represented on certain committees. The Department will also consider whether it is appropriate to undertake any preparatory work ahead of Passenger Focus acquiring statutory responsibility to represent air passengers.

Summary of key proposals

7.40 To summarise, we do not believe consultation responses have raised any fundamental issues which undermine the purpose or viability of the original proposal. We also note that no stakeholder contested the view that Passenger Focus was an authoritative and influential passenger advocate in the rail sector. Therefore we continue to believe that Passenger Focus is the most appropriate body to represent air passengers in Great Britain and that this should be funded via the airport licence fee. This will ensure that passengers have an independent, authoritative and influential passenger advocate whose integrated perspective will be more aligned with the passengers’ own perspective. In this way we believe this decision builds on the Pilling model of a strengthened AUC. This decision is also consistent with wider Government policy, which has generally been to reduce the number of sector specific consumer representation bodies. We recognise that stakeholders have raised a number of practical issues around implementation, in particular around how Passenger Focus will interact and work with other bodies, and we will ensure that these are addressed in implementing this decision.
8. Aligning airports’ capital expenditure programmes with user needs

Introduction

8.1 This chapter considers three aspects of our proposals that are intended to help place passengers at the heart of the new regulatory regime, and provide the Civil Aviation Authority (CAA) with more powers and the flexibility to ensure that the regulatory regime best meets the needs of passengers. The proposals in this chapter are intended to empower the CAA and the Government is seeking to leave it to the independent regulator to effectively protect and further the interests of passengers. In this chapter we consider how the regulatory regime can build on the progress to date with Constructive Engagement (explained below) to ensure that as far as possible, the expenditure programmes of Tier 1 airports, best meet the needs of passengers, through engagement between airports, airlines and passenger representatives. We go on to consider how service quality measures could potentially be developed to align even further with consumers’ views on overall journey outcomes. Finally, we consider how flexibility for the CAA to allow different terminal operators at the same airport can be permitted within the new regulatory framework.

Aligning airports’ capital expenditure programmes with user needs

Government's proposal

8.2 In the consultation the Government explained that it welcomed the CAA’s introduction of Constructive Engagement (CE) and saw the process as a very positive way to engage consumers, airlines and other stakeholders in the regulatory process. The consultation also recognised that some stakeholders have expressed concerns about how aspects of the CE process had operated in practice, including with regard to adequate provision of information by BAA, and whether the CAA should have taken a more active role in the CE process. The consultation recognised the importance of giving the CAA strong information gathering powers, and also indicated that the Government would encourage the CAA to take a more active role in aspects of the process, but recognised that this could be done in different ways. The consultation also recognised that the CAA and other
stakeholders are better placed than the Government to work out the detail of many of these arrangements.

8.3 The consultation sought views on two specific questions (question 9.1):

- What specific information gathering powers will the regulator need to facilitate an effective Constructive Engagement process?
- What information do airlines require to empower them to influence investment programmes in the interests of consumers?

Consultation responses

8.4 The airport operators generally thought that the level of information being provided in the process of CE was appropriate. The Airport Operators Association felt that the information required to facilitate effective CE was no more than that set out by the CAA in the 2001/02 regulatory review. This included:

- The principal business drivers behind the airports’ business plans;
- the forecast demand for airport outputs for the duration of the plan;
- the capacities and other outputs that the airport intends to provide;
- options for the development of the airport around the central plan;
- the resourcing implications behind the development plan;
- cost estimates of individual projects or areas of spend within the capital expenditure programme; and
- the outputs that are expected from individual projects.

8.5 The Airport Operators Association also noted that airlines should not expect fully designed and costed schemes for anything beyond a couple of years. The Airport Operators Association was not supportive of the idea of providing the airport operator’s business plan because this was seen as potentially revealing the airport’s strategy to its competitors and therefore as being anti-competitive. In terms of the process of CE, the Airport Operators Association suggested that the regulator should become a facilitator within the process if requested by either the airport operator or the majority of airlines at a particular airport. London City Airport, Birmingham International Airport and Manchester Airports Group expressed similar views as the Airport Operators Association on the issue of CE. BAA also thought that the level of information currently provided to airlines to empower them to influence investment programmes was appropriate.

8.6 A number of airport operators also expressed the view that the airlines should be required to provide more information. Belfast and Cardiff International Airports thought that airport development plans and service quality might be enhanced if committed airline development plans were available. Gatwick Airport also suggested that there was a case for increasing information provision by parties other than the airport operator.
8. Aligning airports’ capital expenditure programmes with user needs

8.7 In general, the airlines felt that more information from airport operators was necessary. British Midland (Bmi) included a list of information which they required, including:

- a capital investment plan with low, base and high case traffic options;
- traffic forecasts – low, base and high;
- capital investment plan with different service level options;
- impact on operating costs of all the options;
- a benchmarking process that compares externally & internally the major capex proposed; and
- clear links to capital investment plans and masterplans.

8.8 The Board of Airline Representatives UK made the point that airlines required a full understanding of the capital investment programmes and operational expenditures in order to participate in them. British Airways (BA) was also concerned that the business plan had evolved over time into a capital investment plan document. BA noted its view that while the capital investment plan is improving in quality, there is still an issue about the availability of information. In particular, the level of granularity of the information is seen as being sufficiently opaque to prevent effective examination. BA did note that Heathrow and Gatwick airports were currently reviewing with the airlines and the CAA improvements to the information provisions.

8.9 The CAA was aware that the inadequacy of information flow from BAA to the airlines was a consistent complaint of many airlines involved in CE. CAA thought that the issue in relation to information was divided into two main problems – the timeliness, scope and depth of the regular flow of information and the provision of information about changing circumstances and/or BAA plans. CAA noted its view that the concern about information provision was partially addressed by the 2003 agreement on enhanced consultation and information disclosure. However, despite a step up in information from BAA, CE exposed the gaps and weaknesses in this consultation protocol and as a result CAA noted that the agreement had been significantly strengthened.

8.10 In terms of information gathering powers, the CAA noted that the regulator would need wide-ranging information gathering powers to carry out the full range of its regulatory functions. The CAA therefore thought that any information gathering powers for the CAA should not be framed in the context of facilitating consultation processes between airports and airlines but more widely, for the purposes of carrying out all of its regulatory functions. The Regional Development Agencies (RDAs) welcomed the intention to give the CAA robust information gathering powers at regulated airports.

8.11 Gatwick Airport Consultative Committee also agreed that the regulator should be given more robust information gathering powers. They also thought that the regulator should be given powers to distribute information to airlines, and other key stakeholders involved in the process. On that
point, Gatwick Airport noted that any revised powers for the CAA to require and publish information should be accompanied by the ability to appeal a decision to publish information if the airport operator considers that it would be detrimental to its commercial interests.

**Government’s decision**

**8.12** The Government recognises the significant additional value that has been added to the regulatory and price control review process by the CAA’s introduction of CE. We also recognise that like any process of this type it can be expected that all participants will learn lessons about how the process can be improved over time. It is clear from the responses to the consultation that there are different views from different stakeholder groups about how to make the process work more effectively.

**8.13** The Government expects that an effective process for consulting with airlines and other key stakeholders at airports as part of the development of proposals for price and service quality regulation will be a key part of the new licensing regime. The Government is proposing to give the CAA strong and flexible powers of enforcement to ensure that such processes work effectively, and that the relevant airports share information with airlines and passenger representatives in a timely and appropriate manner. In particular, the new licensing regime will need to reflect the consultation and transparency criteria set out, in particular, at article 6, 7 and 8 of the Airport Charges Directive (ACD). These will be reflected in mandatory parts of both Tier 1 and Tier 2 licences and will require an airport operator to provide, at a minimum, information referred to in Article 7(1) of the Directive.

**8.14** While the Government is clear about the importance of an effective consultation and information process, we are also clear that the CAA, in consultation with stakeholders (including airports and airlines), is better placed than the Government to develop the detail of such arrangements in accordance with the requirements of the ACD. Over and above the mandatory consultation processes to be put in a licence, the Government would expect licences to contain a requirement that the airport develop a Consultation and Information Protocol consistent with provisions set out in the licence, which the CAA would be required to approve. We recognise that the existing Information Protocols will substantially inform the development of these new protocols, but we also consider that it is important for the airports and the CAA to consider carefully what changes should be made to better meet the new passenger focus for economic regulation.
Service quality regime

Government’s proposal

8.15 The consultation noted that there was broad industry and stakeholder support for the CAA setting minimum standards for service quality at airports that have substantial market power and where regulatory intervention is warranted (effectively Tier 1 airports under the new regime).

8.16 The consultation also noted that the Service Quality Regimes (SQRs) focus on activities that are controlled by the airport operator only. Given feedback from focus groups and surveys indicating that the experience of passengers at an airport is part of a wider end-to-end journey, the Government felt that it was sensible to consider whether the SQRs ought to be extended to parts of the passenger experience that are controlled by parties other than the airport operator.

8.17 The consultation sought views on an approach where the airports had some targets that better reflect a passenger’s entire end-to-end journey and were more holistic in nature which could then be used as the basis for contractual obligations between the airport and airlines. The Government also noted that a number of criticisms had been made of the way that service quality was measured by the current SQRs.

8.18 The consultation asked three specific questions (questions 9.2, 9.3 and 9.4):

- Is there a need for the CAA to consider extending SQRs beyond those activities under the direct control of the airport operator? What would be an appropriate mechanism for doing so?
- How could the SQR metrics be changed to provide a better fit to the outcomes that affect passengers’ experience? Should someone other than BAA monitor the SQR metrics?
- How might incentives upon airport operators to deliver appropriate levels of service quality be improved in the new regime to produce better outcomes for consumers?

Consultation responses

8.19 Responses on SQRs and the possible extension of these to activities outside the direct control of airport operators expressed a mixed range of views. The Air Transport Users Council questioned whether these other activities should be included in the service quality regime. The Board of Airline Representatives noted its view that SQR metrics should not be extended to cover activities that were beyond the control of the airport. Rather, in their view, the SQR metrics should cover the aspects of airport service provision where the provider was not subject to effective competition. BA and easyJet agreed with this view.

8.20 Instead of extending SQRs, BA proposed that there should be a new approach that would involve independent monitoring and stronger measures in relation to runway resilience. They wanted to see the SQR
regime restructured into four groups, with all elements in a group required to be met as a whole. These groups included airspace, runway and airfield operations, aircraft operations, security measures and terminal services.

8.21 The Chartered Institute of Logistics and Transport thought that the idea of extending SQRs to other organisations was interesting but also that it was probably unenforceable. Gatwick Airport Consultative Committee also thought that there would be difficulties in other parties being held to account for poor performance. Manchester Airports Group noted that airports would like to see the extension of SQRs to other parties operating at the airport, however, this was thought to be difficult in practice because it would require a considerable extension of the remit of the airport regulatory system. Manchester Airports Group noted its own Generic Service Standards (which are akin to service level agreements) which it saw as providing some guidance about how to achieve a more ‘holistic’ approach.

8.22 There were a number of responses that thought it would be useful to extend SQRs beyond airport activities. Belfast and Cardiff International Airports, London First, Consumer Focus and Which? held this view. Birmingham International Airport felt that a strong direction to refocus service level agreements on the passenger experience would encourage airports and airlines to work together and would help ascertain where service failures had originated. The Campaign to Protect Rural England thought that the SQR should go beyond the passenger experience and should include the impact on the environment of operations at all commercial airports.

8.23 The Airport Operators Association felt that the CAA’s redefined duties could enable the development of more targeted and appropriate service quality regimes, including the need to relax such regimes where competition was working effectively. The current SQR scheme was seen as being complex and further complications would risk making it more costly to run with uncertain benefits for consumers.

8.24 The CAA noted that SQRs would only be applied to airports holding a Tier 1 licence on the basis that they held substantial market power. The CAA considered that to be appropriate as competition was seen as a better means of promoting passengers’ interests. The CAA felt that the government did not need to come to a view on these matters of detailed regulation in the context of devising a new overall framework for regulation. The CAA also cautioned that SQRs would need the flexibility to change over time.

8.25 The Department’s Security and Contingencies Directorate (TRANSEC) raised the point that while they do take account of the impact of their requirements on passengers, their primary concern is to ensure that the security response is proportionate to the threat faced. However, any target which encompasses security queues risks having a negative impact on the standards of security achieved.
Government’s decision

8.26 A number of responses were supportive of the idea of extending SQRs for Tier 1 airports beyond those services which are directly controlled by the airport operator to better encompass the overall passenger experience when flying, although some noted that this might be a difficult task. The new licence based regime will only enable the CAA to directly regulate the airport operator as it is the airport operator who will require a licence to operate. The CAA will therefore have no means of directly regulating third parties, including airlines. That said, if the CAA concluded that if an airport was subject to competition it would be better incentivised to: i) ensure coordination between the services it provides directly and those which it subcontracts/rents out to third parties; or ii) influence the quality of service provided by third parties with which it contracts, then we would expect the CAA to take appropriate action, perhaps initially by putting in place incentives for the airport operator to deliver outcomes which more closely mirror those of a competitive, well-functioning market. This would be in line with its primary duty to promote the interests of passengers.

8.27 While the Government continues to see substantial merit in wider service quality measures, we recognise that the CAA is best placed to consider the detail of such measures as part of future reviews of price regulation for Tier 1 airports.

Developing and operating competing terminals

Government’s proposal

8.28 We proposed that for those airports where there is substantial market power, where ongoing regulation in the future would be required and where effective inter-terminal competition has the potential to develop, the regulatory framework should not preclude the possibility of separating the operation and development of terminals. The current regulatory framework does not clearly permit such an approach.

8.29 The consultation document acknowledged a number of benefits associated with the operation and development of competing terminals but also a number of risks and noted that whilst this approach had been introduced in a number of countries, the circumstances leading to its introduction were often different from those that currently apply in the UK aviation sector. As a result we proposed to introduce a regulatory framework that would not prohibit its introduction if the CAA considered that it would further passengers’ interests. The following question was put to stakeholders (question 9.5):

• We would welcome comments both on the merits of allowing terminal competition and the best way for the regulatory framework to permit such competition.
Consultation responses

8.30 In its report on the BAA airports, the Competition Commission noted that where divestiture was not a viable option to address uncompetitive features in the airports market, then terminal competition may have a role. easyJet was in favour of enabling moves towards terminal competition, where this was appropriate. The CAA, Gatwick Airport and the AUC provided qualified support for inter-terminal competition but noted there were practical difficulties involved and although it did not necessarily support terminal competition, BA agreed the option should be kept open.

8.31 The potential introduction of inter-terminal competition was opposed by the airports, their representatives, a number of airport consultative committees as well as some other stakeholders. BAA thought that inter-terminal competition would introduce coordination challenges which could have negative impacts on passengers and other airports thought there was little evidence on inter-terminal competition. Some stakeholders believed that such competition could create extreme problems in long term planning of the airport and the timing of investment. The Department’s Security and Contingencies Directorate (TRANSEC) also had concerns about terminal competition. First, that there might be a lack of clearly defined and allocated accountabilities for ensuring delivery of security at a particular location. Second, there would be added complexity of co-ordinating security issues. Finally, a resource burden might develop in regulating security arrangements amongst multiple parties at large airports.

Government’s decision

8.32 If, at some point in the future, the CAA concludes that terminal competition would be in passengers’ interests, we acknowledge that there would be a number of practical issues that would need to be resolved. First and foremost it is absolutely crucial that clearly defined and allocated accountabilities for ensuring delivery of security at a particular location are maintained if terminal competition were introduced. In order to ensure accountability for the provision of effective security at an airport, there would need to be a single point of accountability for the security of each component part of the airport infrastructure, and for any common parts or processes. The CAA would therefore need to consult with both TRANSEC and the incumbent airport operator to ensure that single points of accountability are possible under terminal competition before it permitted the introduction of such an approach. Secondly, we agree that terminal competition could result in additional (although not significant) resource costs as a result of regulating a larger number of parties, but we believe these additional costs should be manageable, and that the CAA would only propose its introduction if it was confident that the overall benefits exceeded the costs. Finally there may be other risks associated with competing terminals, including coordination challenges and the possibility of exclusionary behaviour and we would expect the CAA to satisfy itself, in consultation with relevant stakeholders, that these risks can be addressed under a system of terminal competition. We would also expect the CAA to ensure that terminal competition would not undermine the efficiency at the airport (e.g. it should not undermine the ability of Air Traffic Control to plan...
and manage all movements across the whole airfield in the most efficient and effective way).

8.33 Although there are some risks associated with terminal competition, there are also a number of potential benefits. Firstly, it might represent one way of delivering more timely and appropriate investments as development of terminals is a lot less ‘lumpy’ than the development of new runways. Secondly, it would allow airlines to tailor the services offered at the terminals to their needs which could improve the passenger experience as terminals would better reflect the needs of consumers. Thirdly, this approach may reduce on-going regulatory costs, since where effective terminal competition develops the CAA would only need to regulate runway facilities.

8.34 To summarise, we do not believe that consultation responses have identified any issues which convince us that the new regulatory regime should explicitly preclude the development of terminal competition in the future. As the CAA, in assessing whether terminal competition at a particular airport would be in the interests of passengers, would need to ensure that any potential risks are addressed, we believe the new regulatory regime should not prohibit the development and operation of competing terminals.

Summary of key decisions

8.35 In this chapter we have proposed that:

- To help ensure that Tier 1 airports’ expenditure programmes are better linked to passengers’ needs, the CAA should build on the progress of Constructive Engagement through enhanced information and consultation provisions in licence conditions. These conditions will build on the requirements of the ACD (the provisions of which will also be applicable to Tier 2 airports).

- The CAA should be encouraged to consider whether wider service quality measures would be appropriate to improve the overall passenger experience.

- Inter-terminal competition should not be precluded under the new regulatory regime where the CAA considers that it will bring benefits to passengers.
Annex 1: Questions for Stakeholders from the consultation document

Statutory remit for the economic regulation of airports

Q6.1 Does the proposed hierarchy of the duties – with a single primary duty supplemented by a set of further duties that the regulator should also consider when seeking to achieve its primary duty – provide sufficient certainty over the regulator’s priorities? Are there alternative arrangements which would provide additional regulatory clarity?

Q6.2 (a) Do you agree with the proposed primary duty? Do you have any comments on the drafting of the primary duty?

(b) Do you agree with the proposed approach of putting the passenger experience at the centre of the regulatory regime with additional rights for airlines and enhanced consumer representation?

(c) Is promoting effective competition the best way to promote the interests of consumers of airport services?

Q6.3 Do you agree that it is appropriate for the economic regulator of airports to have regard to environmental limits? Does the proposed duty provide sufficient clarity over the respective roles of the Government and the CAA? Does the proposed duty risk compromising the clarity of the regulator’s primary duty?

Q6.4 Given the proposed primary duty to promote the interests of consumers, is it necessary to have a further duty to ensure that all reasonable demands are met efficiently?

Q6.5 Given the proposed primary duty to promote the interests of consumers, is a further financing duty required? What is the appropriate interpretation of a financing duty in the airports sector?

Q6.6 What is the appropriate interpretation of a financing duty in the airports sector?

Q6.7 Does the proposed duty provide the right balance between the roles of the Government and the CAA? Does the proposed duty risk compromising the clarity of the regulator’s primary duty?
Q6.8 We would welcome comments on the appropriateness of the proposed duties and in particular, whether they will allow for an effective and efficient regulatory regime that meets the Secretary of State’s objectives for the Review. In considering the proposed duties stakeholders may wish to respond particularly on:

- Whether the proposed duties provide a sufficiently clear framework for the CAA to operate within?
- Whether the proposed hierarchy and number of duties for the CAA are appropriate?
- Whether there are other factors or issues that should be included in additional specific duties?
- Whether the initial draft wording for the duties is appropriate.

Designing a flexible, fair and effective enforcement regime

Q7.1 Do stakeholders agree with the proposed approach to developing a new licensing regime for airports?

- Do you agree with the proposed tiers for the licenses, including the criteria and thresholds that will be used to determine which tier an airport will be in?
- Do you agree that the criteria for determining whether an airport has a Tier 1 licence should be enshrined in Primary Legislation?
- Do you agree that the regulator should retain the option of regulating small airports that have substantial market power with a Tier 1 licence, including a price control, subject to the satisfaction of the criteria set out above and the appeal process?
- Do you agree that the regulator should be able to impose a Tier 3 licence on certain small airports that would allow market power at these airports to be addressed whilst stopping short of price control?

Q7.2 Do you agree with the principle of using the proposed licence regime for the economic regulation of airports to implement certain aspects of the Airport Charges Directive?

Q7.3 We would welcome comments on these initial thoughts about the conditions that should be included in the license for each tier.

Q7.4 We view the introduction of the proposed licensing regime as being beneficial to consumers although we understand that there will be associated implementation costs. What do you think the likely scale and value of these costs will be?
Q7.5  We would welcome comments on the proposed process for changes to licence conditions. We would particularly welcome comments on the proposed process for collective licence modifications.

- Do you agree that in a reformed regulatory regime the Secretary of State should retain the right to refer changes to licence conditions, even where agreed by the licensee, to the Competition Commission? Is this an appropriate scope for an intervention power for the Secretary of State?

- Do you agree that where a proposed change of licence condition would apply identically to a group of airports that this change would come into effect if it was accepted by 80% of these airports representing 80% of total passenger numbers across the group?

Q7.6  Do you agree with the proposals to put in place similar provisions for sanctions and enforcement by the CAA for the airports sector that apply in the other main regulated sectors in the UK? Are there are any particular features of the airports sector that would justify or require a different approach to licence revocation?

Q7.7  Do you agree that the CAA should have concurrent competition law powers for airport services in the UK?

Enhancing accountability

Q8.1  We would welcome views on the proposed approach to allowing appeals regarding CAA decisions about whether an airport should have a Tier 1 licence and regarding licence modifications. We would particularly welcome comments on which parties should have the right to appeal and on which decisions particular parties should have the right to appeal. We would also welcome views on the most appropriate approach to ensure that appeals are neither frivolous nor vexatious.

Q8.2  Do you agree with the proposal that the CAA would be required to consider the regulatory status of a Tier 1 airport at the end of each price control period (the sunset clause)?

- Do you agree with the proposal that CAA decisions about whether an airport should have a Tier 1 licence should be subject to a merits based appeal to the CAT?

- Do you agree that access to merits based appeal on the CAA’s decision about whether an airport should have a Tier 1 licence should be granted to all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators?

- How should provision be made in the new regime to deter frivolous or vexatious appeals?
Q8.3 As set out at the beginning of this section, we would welcome stakeholders’ comments on how the right of appeal on licence condition changes should be framed. The three options we would like specific feedback upon are:

- Option 1 – Rights to a merits-based appeal on all licence modifications granted to all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators;

- Option 2 – Rights to a merits-based appeal on all licence modifications granted to the licensee. A right of appeal for other parties with a material interest (including airlines, specified consumer groups and other airport operators) on a limited range of issues, including – but not limited to – the CAA’s decision on whether an airport should be subject to a Tier 1 licence. Within this option there are sub options relating to how appeal rights could be extended beyond the licensee upon which we would welcome stakeholders’ views. Two sub options, that are not necessarily exclusive are:
  - A right of appeal on the CAA’s decision to endorse an airport operator’s statement of charging principles setting out how a price control once set will be translated into the detail of airport charges.\(^66\)
  - A right of appeal on a statement of principles by the CAA setting out the fundamental basis on which price control decisions are made (as set out at paragraph 8.7).

- Option 3 – Rights to a merits-based appeal on all licence condition changes granted to the licensee. Other parties with a material interest (including airlines, specified consumer groups and other airport operators) granted access to a merit based appeal on the decision whether an airport should have a Tier 1 licence but not to licence modification decisions.

Q8.4 Does a procedure which involves either the agreement of the licensee only or a determination of the public interest by the Competition Commission properly take account of airline and other third party views?

Q8.5 Should airlines and other third parties have a specific right to be consulted on proposed licence modifications?

Q8.6 Do you agree that Tier 1 and 2 airports should be required to submit an annual report to the CAA and other environmental regulators about their environmental performance? Are there any specific requirements that you consider should be in such a licence condition?

Q8.7 The Government is considering applying the Compliance Code to CAA’s economic functions. Are you in favour of extending the coverage of the Code in this way? Please give reasons to support your views.

\(^66\) This option has been proposed by the Review’s independent Expert Panel.
Aligning airport services with passengers’ needs

Q9.1 What specific information gathering powers will the regulator need to facilitate an effective Constructive Engagement process? What information do airlines require to empower them to influence investment programmes in the interests of consumers?

Q9.2 Is there a need for the CAA to consider extending Service Quality Regimes (SQRs) beyond those activities under the direct control of the airport operator? What would be an appropriate mechanism for doing so?

Q9.3 How could the SQR metrics be changed to provide a better fit to the outcomes that affect passengers’ experience. Should someone other than BAA monitor the SQR metrics?

Q9.4 How might incentives upon airport operators to deliver appropriate levels of service quality be improved in the new regime to produce better outcomes for consumers?

Q9.5 We would welcome comments both on the merits of allowing terminal competition and the best way for the regulatory framework to permit such competition.

Q9.6 The DfT would welcome the feedback of stakeholders on the issues raised relating to airports’ financial resilience, in particular:

- Should the DfT introduce a Special Administration regime for the airports industry?

- Are airports sufficiently important assets for the Government to take steps to ensure their continued operation? If the Government were to introduce Special Administration for airports how should this be designed and implemented? Do you believe that a staged implementation of the Special Administration regime over a period of time would be helpful?

- Should the regulatory regime be reformed to allow the regulator to introduce licence conditions to ring-fence regulated assets?

- Should the regulatory regime be reformed to allow the regulator to introduce licence conditions obliging regulated businesses to maintain an investment-grade credit rating and if so in what form?

- How might such provisions be introduced to minimise disturbance to existing financing arrangements?
Enhancing consumer representation within the aviation sector

Q10.1 Do you agree with the proposal to give Passenger Focus responsibility for consumer policy advocacy with regards to airlines and airports, funded through airport licence fees? In particular, we welcome views on the proposal for Passenger Focus to develop and support a network of consumer panels at leading airports.

Q10.2 Do you agree with the proposal to give Passenger Focus responsibility for complaints handling on airline and airport issues alongside its policy advocacy function?

How can we best ensure the expertise and sector knowledge in relation to EU air passenger rights built up over time by the AUC is retained?
## Annex 2: List of respondents

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Annex 3: Statutory undertaker rights and obligations

Under the Airports Act 1986 any airport that holds a permission to levy airport charges is deemed to be a statutory undertaking, and a relevant airport operator as a “statutory undertaker” for the enactments listed in Schedule 2 of the Act. These enactments are:67,68

- **Acquisition of Land Act 1981.** This Act confers protective rights on statutory undertakers whose land is included in a Compulsory Purchase Order either for acquisition or for the creation of new rights over the land.

- **Part 1 Local Government (Miscellaneous Provisions) Act 1976.** This Act confers protective rights on statutory undertakers whose land is surveyed by a Local Authority prior to the making of a Compulsory Purchase Order.

- **New Towns Act 1981.** This Act confers protective rights on statutory undertakers whose operational land is included in a Compulsory Purchase Order made by a development corporation for the establishment of a new town.

- **Section 296 and Section 611 of the Housing Act 1985.** These provisions confer protective rights on statutory undertakers where (i) their land is the subject of compulsory acquisition and (ii) where their apparatus is affected by the stopping up/diversion/alteration of any street by a Local Housing Authority.

- **Section 330 and 333 Public Health Act 1936.** Section 330 confers special powers on statutory undertakers to alter or divert any sewers, drains, culverts or pipes vested in the local authority which pass under or interfere with the improvement of the statutory undertaking.

Section 333 confers protective powers on a statutory undertaker preventing a local authority from interfering with the operation of the statutory undertaking without the consent of the statutory undertaker.

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67 Separate arrangements exist in Northern Ireland for deeming airports as statutory undertakers.

68 An airport has statutory undertaker status if it has a subsisting pending application for a permission to levy charges under Part IV of the Airports Act 1986 and it is not for these purposes an excluded airport under Section 57(2) of that Act.
- **Building Act 1984.** This enactment confers protective rights on statutory undertakers where the local authority seeks to take action in respect of the drainage of a building.

- **New Towns (Scotland) Act 1968.** This act confers protective rights on statutory undertakers whose operational land is included in a Compulsory Purchase Order.

- **Acquisition of Land (Authorisation Procedure) (Scotland) Act 1947.** This Act confers protective rights on statutory undertakers whose land is included in a Compulsory Purchase Order either for acquisition or for the creation of new rights over the statutory undertaker’s land.

The rights and responsibilities of statutory undertakers under the following primary and secondary legislation have also been conferred upon a relevant airport operator:

- **Part 18 Class A of the General Permitted Development Order 1995** grants deemed planning permission to a relevant airport operator in connection with development: for the provision of services and facilities at a relevant airport; for the provision of air traffic services (both within and without the perimeter of the relevant airport); the use of buildings within the perimeter for air transport services/flying activities at that airport.

- **The Climate Change Act 2008** gives the Secretary of State the power to direct statutory undertakers (which here includes a relevant airport operator) to provide reports on: the current and future predicted impacts on climate change of their organisation; and proposals for adapting to climate change.

- **The Planning Act 2008** makes provision for the Government to provide National Policy Statements that integrate environmental, social and economic objectives and provide clarity on what the need for infrastructure is. These will be prepared with the objective of contributing to the achievement of sustainable development including, in particular, the desirability of mitigating and adapting to climate change.

It will be a legal obligation to consult the following bodies before designating a statement as a national policy statement: devolved administrations; regional and local government bodies; relevant executive agencies and Non Departmental Public Bodies (NDPBs); statutory undertakers (where relevant to the content of the National Policy Statement) and representatives of statutory undertakers’ employees.

National policy statements will identify one or more statutory undertakers as appropriate persons to carry out a specified description of development.

- **Coal Mining and Subsidence Act 1991.** This act confers protective rights on statutory undertakers in respect of the working of minerals.
• **Environmental Protection Act 1990 – Part IV, and Litter (Statutory Undertakers) (Designation and Relevant Land) Order 1991.** The Act and Regulations impose an obligation on a designated statutory undertaker to keep, as far as may be practicable relevant land clear of litter and refuse. A relevant airport operator is “a designated statutory undertaker” for the purposes of this legislation.

• **Regional Development Agencies Act 1998.** This enactment confers protective powers on statutory undertakers preventing the Secretary of State from vesting in a Regional Development Agency any land that is used or held by a statutory undertaker for the purpose of carrying out its undertaking.

• **Transport Act 2000.** Extends the definition of statutory undertaker to include a person to whom a licence is granted under Part I of the Transport Act 2000.

• **Town and Country Planning Act 1990.** This Act deals generally with the rights and responsibilities of a statutory undertaker under planning legislation.

• **Conservation (Natural Habitats Etc) Regulations 1994.** These Regulations provide that byelaws made under Section 20 of the National Parks and Access to the Countryside Act 1949 shall not interfere with a statutory undertaker’s operation. Further, statutory undertakers are unaffected by those provisions of the regulations restricting the operation of certain planning permissions.

• **Tree Preservation Order Regulations.** These regulations contain a special power allowing a statutory undertaker to cut down, lop or otherwise carry out works to a protected tree on the operational land of the statutory undertaker where such work is required: in the interest of the safe operation of the undertaking; to enable the undertaker to carry out development permitted under the Town and Country Planning Act (General Permitted Development Order).

• **Transport Act 2000 (Consequential Amendment) (Scotland) Order.** This order widens the definition of statutory undertaker in certain planning enactments to include the relevant airport operator.

• **Town and Country Planning (Scotland) Act 1997.** The 1997 Act deals generally with the rights and responsibilities of a statutory undertaker under Scottish planning legislation.

• **Section 125 Housing (Scotland) Act 1987.** Section 125 empowers a Local Authority to seek the demolition of a building which is dangerous or injurious to health. This power does not apply to properties owned by a public undertaker. A relevant airport operator is deemed to be a public undertaker for the purposes of this section.