Reforming the framework for the economic regulation of UK airports
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1. Executive summary

1.1. This consultation seeks views on the UK Government’s proposals to update and change the framework for the economic regulation of the UK airports sector. The proposals are intended to provide a flexible economic regulatory framework for the sector that puts the passenger experience at the centre of regulatory decision-making and processes as well as emphasising the environment, financeability, and the principles of Better Regulation. We propose that the Civil Aviation Authority (CAA) should regulate fewer airports but be given more powers, with appropriate checks and balances, to further the interests of passengers and adapt the economic regulatory regime to reflect differences across the airports sector and changes over time.

1.2. We will consult later in the year on proposals to take forward key environmental commitments made when Government announced support in principle for the construction of a third runway at Heathrow airport. These will include proposals on a new “green slot” principle and mechanisms to ensure that additional flights at Heathrow can only be allowed when noise and air quality limits at Heathrow are complied with. This subsequent consultation will also set out how the Government intends to implement the recommendations from Sir Joseph Pilling’s strategic review of the CAA.

Context to reforming the economic regulation of airports

1.3. Under the Civil Aviation Act 1982 and subsequent Legislation, the CAA regulates in four areas: safety, air space, consumer protection and economic regulation of airports and NATS. In 2008, the Government commissioned two separate, but complementary reviews of the CAA’s role:

- A strategic review of the CAA’s overall scope, structure and organisation undertaken by Sir Joseph Pilling. This review reported in June 2008.
- An in-depth review of the economic regulation of airports undertaken by the Department for Transport (DfT), recognising that this aspect of the regulatory regime was set up over 20 years ago and much had changed since it was established.

1 The overarching framework for the economic regulation of airports in Scotland and Wales is a reserved matter with DfT retaining responsibility for policy development. The separate legislation that provides a framework for airport regulation in Northern Ireland currently closely follows that for other parts of the UK and is overseen by the CAA. DfT will work closely with the Devolved Administration in developing policy for Northern Ireland.
Executive summary

1.4. It is the conclusions of the review of economic regulation that are set out in this consultation document. However these need to be considered in the context of the former. As the Review’s independent Expert Panel has pointed out, economic regulation cannot be considered in isolation, and the governance arrangements of the CAA can be expected to play an important role in the operation of the regime in practice. The Government has already accepted Sir Joseph Pilling’s recommendations that this legislative framework needs to be brought up to date. Of particular relevance here is his conclusion that the CAA’s general statutory remit does not adequately reflect its responsibility for safeguarding the public interest. The Government is developing proposals for future legislation that will, amongst other things, give the CAA a clear focus on actively pursuing consumer-related and environmental objectives whilst at the same time maintaining the strength of its existing focus on securing a high standard of safety.

1.5. In addition to proposed changes to domestic legislation, airport charges at a number of UK airports are to be subject to new legislation arising from Europe by Spring 2011. An Airport Charges Directive (ACD) has been negotiated by Member States, the Commission and the European Parliament and is expected to become EU law in Spring 2009. The UK, and other Member States, will then have 2 years to implement the Directive’s provisions. The Directive sets a common framework regarding the principles of how airport charges should be established and the associated relationship between airports and airlines. We have developed our proposals for economic regulation taking account of the Directive. How the UK intends to implement the specific provisions will be subject to a separate consultation, expected in 2009.

Proposed reforms to the economic regulation of airports

1.6. There are three themes that run through our proposals for reforming the economic regulation of airports. These are:

- Putting the passenger experience first, which requires appropriate levels of investment but which must be balanced by the effects on the environment and associated impacts on local communities.

- Creating an efficient, flexible and effective economic regulator that is able to adapt the regulatory regime to reflect the differences across the airports sector and changes over time.

- Recognising the principles of Better Regulation and the value of having an independent economic regulator to deal with substantial market power, or dominance, but also accepting that some decisions require political judgements best taken by a democratically elected Government.
Reforming the statute duties of the economic regulator

1.7. We propose to reform the statutory remit of the economic regulator of UK airports. Key reforms include:

- A primary duty to promote the interests of passengers;
- Further duties to have regard to the environmental impacts of airport development, to meet reasonable demands for airport services efficiently, to ensure that airports can finance their activities and to assist in the delivery of airport infrastructure consistent with the National Policy Statement.

1.8. These reforms to the duties for economic regulation would put the passenger experience at the heart of the new regime. It also recognises that part of improving the passenger experience means investing in new capacity, and that investment has consequences on the environment and local communities.

Introducing a new licence regime

1.9. Licenses allow economic regulation to be used in a targeted and flexible way. Their introduction for airports would mark a significant improvement in the flexibility of the regulatory regime. The economic licensing regime can also be used as a proportionate and effective means to implement some of the provisions of the Airport Charges Directive which is due to come into force from 2011. The detailed content of each licence will be subject to consultation, following initial development by the CAA and DfT, along with key Government and other stakeholders. We propose that the licence regime should reflect the size and market power of the airports. In other words, all airports would not be subject to identical regulation. We propose 3 licence tiers:

- **Tier 1**: those with substantial market power or dominance, requiring some form of price and/or service quality control (currently Heathrow, Gatwick and Stansted airports);
- **Tier 2**: those airports with more than 5 million passengers per year (currently 13 UK airports including those subject to Tier 1 licence), which under the Airport Charges Directive, will have to consult on airport charges, provide financial information of certain kinds and meet other obligations;
- **Tier 3**: other airports where the CAA considered it appropriate to introduce a licence. Assuming that no airports are initially licensed on this basis, this approach will mean that 42 airports which currently have to seek permission to levy airport charges will not require an economic licence to operate.

All other airports would be able to operate without an economic licence.

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2 The Government has stated its intention to produce a National Policy Statement on Airports based on the Air Transport White Paper, which satisfies the requirements of the Planning Act 2008. A draft NPS is expected to be published in draft by 2011.

3 In deciding whether an airport should be included in Tier 1 an assessment will need to be made about whether the airport has ‘substantial market power’. The Office of Fair Trading’s website includes guidance about how the concepts of market power and dominance should be assessed.
Executive summary

Appealing decisions

1.10. It is important that any economic regulatory regime has not just clear duties for the independent regulator but also that the system has appropriate checks and balances built into it. The key issues for appeals revolves around which parties have access to challenge the merits of the regulator’s decision on whether an airport should be subject to a Tier 1 licence and which have access to challenge the merits of a licence modification. Judicial review would be available to all parties. In addition, we propose that all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators should be able to challenge the merits of the regulator’s decision on whether an airport should be subject to a Tier 1 licence via an appeal to the Competition Appeal Tribunal. At this stage it is not obvious to us which parties should have access to appeal a proposed licence modification, such as a price cap change. A wide access to the appeal process has the benefit of empowering all parties to hold the regulator to account and minimises the risk of disproportionate regulatory action, although may risk creating a regulatory framework that could become overwhelmed and slowed down by appeals and its efficiency eroded if each of the regulator’s decisions with financial implications is appealed by one party or another. We therefore propose three options on the appropriate structure of the appeal mechanism relating to licence modifications, including those relating to price control and service quality, and on which we seek the views of stakeholders:

- **Option 1** – All parties with a material interest (including the licensee, airlines, specified consumer groups and other airport operators) can appeal a proposed licence modification;

- **Option 2** – Only the licensee can appeal a proposed licence modification. Other parties with a material interest (including airlines, specified consumer groups and other airport operators) would have rights to challenge certain principles on which a modification is made.

- **Option 3** – Only the licensee can appeal a proposed licence modification.

Endorsing governance changes

1.11. We recognise that the statutory remit of a regulator can only go so far in determining regulatory outcomes. The governance arrangements for the CAA will also play a major role in the operation of the regime in practice. Issues associated with governance were recently considered by Sir Joseph Pilling in his Strategic Review of the CAA. The Government has endorsed its recommendations on the reform of the governance of the CAA.

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4 As discussed in chapter 8, this might be facilitated either through the CAA publishing a statement of principles setting out the basis upon which price controls are set. Alternatively, as proposed by the Expert Panel, this could be based upon a statement of charging principles from the airport operator setting out how the price control will be translated into the detail of charges.
Reforming the framework for the economic regulation of UK airports

Enhancing passenger representation

1.12. Consistent with giving the economic regulator a primary duty to further the interests of passengers, we propose a significant strengthening of passenger representation within the sector. We propose that:

- Consumer complaints handling and passenger representation should pass from the Air Transport Users Council to Passenger Focus.
- CAA’s Consumer Protection Group should have an enhanced role, possibly serving as a critical friend and adviser to the CAA’s Economic Regulation Group as it discharges its duties.

Passenger Focus’ new role and the enhanced role of CAA’s Consumer Policy Group would be funded via a levy on the airport licence.

1.13. These proposals are consistent with passengers’ views of airports as one part of a wider end-to-end journey, reflect the fact that airport and airline customers are one and the same and would give the passenger a strong voice in determining the through-airport experience.

Next steps

1.14. We are very keen for all interested stakeholders to respond to this consultation and welcome views on both the package of proposals as a whole as well as the specific questions raised. An Impact Assessment (IA) is published alongside this consultation. When responding to the consultation, please also comment on the analysis of costs and benefits within the IA, giving supporting evidence wherever possible. This will help us develop the most effective regulatory framework for UK airports. The consultation will run for 12 weeks from 9 March 2009 to 1 June 2009 and responses should be sent to:

David Hart
Head of International Networks Analysis and Support
Department for Transport
1/26 Great Minster House
76 Marsham Street
London
SW1P 4DR

Email: david.hart@dft.gov.uk

1.15. Once we have considered the responses to this consultation, the Secretary of State will engage with the Devolved Administration in Northern Ireland to determine how the economic regulation of airports should be reformed throughout the UK. This decision will be published later in 2009. Also this year the Government intends to consult on proposals which take forward key environmental commitments made when it announced support in principle for the construction of a third runway at Heathrow airport. These will include a new “green slot” principle, for the allocation of new capacity to incentivise the use at Heathrow of the most modern aircraft, with further benefits for air quality and noise and carbon dioxide emissions. They will
also include the mechanisms to be put in place ensuring that additional flights at Heathrow could only be allowed when the independent Civil Aviation Authority is satisfied that noise and air quality limits at Heathrow will be fully complied with, following guidance from Transport, Environment and Energy and Climate Change Ministers. Finally, consultation at that time will also detail how the Government intends to implement the recommendations from Sir Joseph Pilling’s strategic review of the CAA which will give the CAA a clear focus on actively pursuing consumer-related and environmental objectives whilst at the same time maintaining the strength of its existing focus on securing a high standard of safety.
2. Undertaking the Review

Introduction

2.1. This consultation seeks views on the UK Government’s proposals to update and change the regulatory regime for the UK airports sector. These proposals seek to put the interests of passengers at the centre of the new regulatory regime. The CAA will be given more powers, with appropriate checks and balances, to develop regulation to further passengers’ interests and adapt the regime as the aviation sector changes. We would welcome comments and feedback on the proposals in this consultation. Responses and feedback will then be reviewed and the Secretary of State will make a decision, with the intention of implementing changes to primary legislation as soon as parliamentary time is available.

2.2. In this chapter we:

- Explain why the then Secretary of State launched a review of the economic regulation of UK airports last year;
- Explain the key sources of evidence that we have considered during the Review;
- Set out the process for interested parties to respond to this consultation; and
- Explain the structure of the rest of the consultation.

Why review the framework for the economic regulation of airports?

2.3. The justification for regulation needs to be periodically reviewed and updated. The current regulatory regime for airports was established over twenty years ago by the Airports Act 1986, and since then there has been considerable change within the aviation sector, particularly the liberalisation of air services in the 1990’s and resulting growth in competition and development of regional airports in the UK. The period has also seen major developments in utility regulation, including changes to the statutory framework for all the other major regulated sectors in the UK.

[5] The overarching framework for the economic regulation of airports in Scotland and Wales is a reserved matter with DfT retaining responsibility for policy development. The separate legislation that provides a framework for airport regulation in Northern Ireland currently closely follows that for other parts of the UK and is overseen by the CAA. DfT will work closely with the Devolved Administration in developing policy for Northern Ireland.
In light of these changes, and with broad support from industry and other stakeholders, in April 2008 the Secretary of State for Transport announced a review of the framework for the economic regulation of airports and explained the reasons for the review and key policy objectives in a Parliamentary Statement. The three policy objectives were:

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

The Secretary of State confirmed that the Review would 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 airport from 1 April 2009.

The Review has considered from first principles the need for any intervention (through regulation or other policy options) in order to meet the objectives set for the Review by the Secretary of State. Once a robust basis for any intervention has been established the Review has then considered as wide a range of options as possible for the appropriate form that the intervention should take. We have followed this approach to ensure that the conclusions reached are robust, and also because this approach is consistent with the principles of Better Regulation.

This consultation builds on the DfT’s September 2008 consultation and response to the Competition Commission’s Market Investigation into BAA airports (the ‘submission’), which responded to the Competition Commission’s Provisional Findings. The submission set out the DfT’s initial view on the need for intervention and identified a range of issues for further analysis and consultation. Since the September submission, we have continued to develop our understanding of the need for intervention, carefully considering a range of evidence from different stakeholders and undertaking further analysis. We have also considered a wide range of options for regulation or other interventions where they are required.

Evidence considered during the Review

Consultations

During the course of the view the DfT has issued a Call for Evidence and held a consultation on its September 2008 submission to the Competition Commission. These consultations have enabled interested stakeholders to submit evidence to the Review. This evidence has been carefully considered, particularly in shaping an appropriate package of proposals. A summary of the main issues raised in the first Call for Evidence, together with all non-confidential responses, was placed on the DfT’s website at the

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6 http://www.dft.gov.uk/press/speechesstatements/statements/stateeconomicregairport
7 For more information see http://www.berr.gov.uk/bre/
time of the submission to the Competition Commission. A summary of the responses to the DfT’s submission to the Competition Commission has been placed on the DfT’s website together with all non-confidential responses. In addition to written evidence that has been submitted we have met bilaterally with a number of stakeholders during the Review.

2.9. Whilst submissions from a wide range of different stakeholder groups were received, the views of air passengers – and in particular of different passenger groups – were under-represented and so we commissioned Independent Social Research Ltd to undertake a series of air passenger focus groups at five locations around the country to gather evidence directly from air passengers on the key issues affecting their end-to-end airport journey experience and their priorities for improvement. Their final report is published alongside this consultation. As discussed further in chapter 4, we have also taken account of surveys of passengers undertaken by the CAA.

The Expert Panel

2.10. The Review has also been advised by a panel of independent experts who have led their own work programme alongside the DfT, with support from the Review team where it was requested. Professor Martin Cave of Warwick Business School chaired the Panel. The work programme of the Panel has included three seminars for interested stakeholders, with details published on the DfT website. The Panel has also met bilaterally with a range of interested parties. The Panel’s final advice to the Secretary of State is published alongside this consultation.

The Competition Commission’s Market Investigation into BAA Airports

2.11. The Competition Commission’s Market Investigation into BAA airports has provided further and very important evidence to the Review. We have worked closely with the Competition Commission and their work has informed our thinking. We note, however, that the Commission focuses solely on identifying features of the market that prevent, restrict or distort competition, whereas the Government must also balance this against issues of wider public policy, such as the impact of aviation on the environment. In some circumstances this may lead the Government to reach different conclusions from the Competition Commission. However, as discussed further in chapters 4 to 8 of this consultation, the Provisional Findings and Provisional Decision on Remedies from the Competition Commission with regard to economic regulation, include many proposals that are consistent with or similar to the proposals in this consultation. The Competition Commission’s final report will be published by the end of March 2009. We recognise that a number of stakeholders have commented upon and questioned aspects of its analysis and we will consider the Competition Commission’s response to these comments in its final report.

8 http://www.dft.gov.uk/pgr/aviation/airports/reviewregulatioukairports/callforevidence/
9 http://www.dft.gov.uk/pgr/aviation/airports/reviewregulatioukairports/
Responding to the consultation

2.12. We are very keen to encourage as many stakeholders as possible to respond to this consultation. Due to our desire to limit regulatory uncertainty, the framework for the economic regulation of airports is unlikely to be reformed again for the foreseeable future. It is very important that the best possible regulatory framework for UK airports is developed, and this will be best achieved by taking account of the views of all the key stakeholders in the aviation sector.

2.13. The consultation is being conducted in line with the Government’s Code of Practice on Consultation, the criteria are listed at Annex 1. A list of consultees is at Annex 2 and if you have any suggestions of others who may wish to be involved in this process please contact us.

2.14. While we would welcome views on all the proposals set out in this consultation, we have sought to direct the consideration of respondents to particular questions that the DfT considers are the most important in ensuring that the proposals are fit for purpose – these are set out in Annex 6. As stakeholders will see the consultation includes a range of specific proposals on which we would welcome views, but also on some issues we set out a range of options on which we would welcome views. We would also welcome comments on whether the package meets the Secretary of State’s three policy objectives for the Review (set out in paragraph 2.4 above). An Impact Assessment (IA) is published alongside this consultation. When responding to the consultation, please comment on the analysis of costs and benefits within the IA, giving supporting evidence wherever possible. Please also suggest any alternative methods for reaching the objectives of the Review and highlight any unintended consequences of the proposals, and practical enforcement or implementation issues.

2.15. The consultation will run for 12 weeks from 9 March 2009 to 1 June 2009 and responses should be sent to:

David Hart
Head of International Networks Analysis and Support
Department for Transport
1/26 Great Minster House
76 Marsham Street
London
SW1P 4DR

Email: david.hart@dt.fs.gov.uk

We would be happy to meet with stakeholders during the consultation and respondents should contact David Hart to arrange such meetings.
2.16. Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

2.17. Once we have considered the responses to this consultation the Secretary of State will make a final decision on proposals to reform the economic regulation of airports. This decision will be published later in 2009. The Government also intends to consult on how it intends to implement the recommendations from Sir Joseph Pilling’s strategic review of the CAA, operate the proposed “green slots” arrangement at Heathrow airport and how we propose to apply enforceable mechanisms – to which we are committed – ensuring that noise and air quality limits at Heathrow are met. A further issue for consultation in 2009 will be how best to put into force the Pilling recommendation that the CAA should be given a statutory environmental duty. We will also consult on how the UK intends to implement the specific provisions of the Airport Charging Directive later in 2009 as well.

Structure of the consultation document

2.18. The remainder of the consultation document is structured as follows:

- Chapter 3 provides background information and wider context about the UK aviation sector.
- Chapter 4 discusses the conclusions that the Review has reached regarding the rationales for policy intervention as a result of the existence or potential existence of substantial market power or dominance at UK airports.
- Chapter 5 discusses the conclusions that the Review has reached regarding the rationales for policy intervention as a result of wider externalities.
- Chapter 6 explains the proposed duties that will underpin the new framework for economic regulation and why we consider these to be the appropriate duties.
Chapter 7 sets out the proposed enforcement mechanisms available to the economic regulator when discharging its duties, including the proposals for a new licensing regime to cover UK airports.

Chapter 8 explains the proposals to ensure sufficient accountability for the decisions made under the new regulatory regime.

Chapter 9 discusses some of the important elements of any new regulatory framework, including proposals to ensure the financial resilience of airports.

Chapter 10 sets out the proposals for enhanced consumer representation within the aviation sector.

Annex 1 provides details of the Government’s Code of Practice on Consultation.

Annex 2 provides a list of consultees to the consultation.

Annex 3 summarises the current legislative regulatory framework for UK airports.

Annex 4 summarises the environmental provisions that affect airport development and operations.

Annex 5 discusses the impacts of aviation on climate change.

Annex 6 provides a list of the questions on specific issues that we are seeking the views of stakeholders.
3. Features of the aviation sector in the UK

Introduction

3.1. As the September 2008 DfT submission to the Competition Commission noted, there have been major changes to the UK aviation sector since the current regulatory arrangements were put in place through the Airports Act 1986. There have also been major developments in utility regulation, including changes to the statutory framework for all the major regulated sectors in the UK. This chapter:

- Provides an overview of the UK aviation sector; and
- Discusses developments in the utility regulation sector over recent decades.

Features of the aviation sector

3.2. The Civil Aviation sector is comprised of scheduled and non-scheduled commercial air transport services carrying passengers and freight. It also includes other operations typically referred to as General Aviation.

Changes to passenger and freight volumes over time

3.3. The UK air transport sector has experienced strong historic growth. A report by the Office of Fair Trading (OFT) in 2007 highlighted that there had been a fivefold increase in air travel over the last 30 years, with annual passenger growth of around 6 per cent, generating over £13 billion of revenues per year. Figure 3.1 shows the growth in passenger numbers between 1981 and 2007; whilst an upward trend is evident it is also clear that growth has not been constant, with periods where growth has slowed and passenger numbers declined. The demand for air freight has also been increasing, particularly during the 1990’s, although freight volumes have been relatively stable since around 2004.

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11 Data from CAA airport statistics website: http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&pageid=3&sglid=3
3.4. Strong historic growth reflects a range of factors including higher demand for air travel resulting from general economic growth and lower air fares, growth following the liberalisation of air services in Europe and with the US, and growth facilitated by the development of a much greater route network. Going forward, whilst growth in air travel is likely to be affected by the recent economic downturn (as it was during the early 1990’s where passenger numbers declined between 1990 and 1992), over the longer-term to 2030 the demand for air travel is forecast to increase further (see Figures 4.2 and 4.3). We note however that despite predicted further growth there are likely to be periods where growth slows and airport operators must bear these commercial risks.

3.5. Given the contribution of the aviation sector to the UK economy, both directly and through the wider economic impacts, as identified by the Eddington Transport Study, it is important that any revised regulatory framework encourages the industry to provide the best outcome for passengers and freight, whilst taking into account the wider impacts of their actions on the UK economy and the environment. We consider these impacts in more detail in chapter 5.
Size and location of airports

3.6. There are a large number of airports in the UK, which vary in terms of their size and location. In 2007 there were 40 airports offering scheduled passenger services. Figure 3.2 demonstrates the variation in passenger numbers at a range of medium and large UK airports. It can be seen that there are essentially two size categories of airports; with four large airports having passenger numbers of more than 20 million per year (Heathrow, Gatwick, Stansted and Manchester), and the remainder with less than 10 million passengers per year.

3.7. Airports also handle freight and different airports handle varying quantities of freight in different ways. Table 3.1 shows that whilst Heathrow airport handled the most freight overall, the vast majority was transported via passenger services with very few dedicated cargo flights. In contrast to Heathrow (and Gatwick) airport, airports such as Nottingham and Stansted handled significantly more cargo aircraft.
Table 3.1 – Freight through UK airports (‘000 tonnes) – 2007

<table>
<thead>
<tr>
<th>Airport</th>
<th>Passenger Aircraft</th>
<th>Cargo Aircraft</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heathrow</td>
<td>1237</td>
<td>74</td>
<td>1311</td>
</tr>
<tr>
<td>Nottingham</td>
<td>0.2</td>
<td>274.6</td>
<td>274.8</td>
</tr>
<tr>
<td>Stansted</td>
<td>1.5</td>
<td>202.3</td>
<td>203.7</td>
</tr>
<tr>
<td>Gatwick</td>
<td>168.6</td>
<td>2.5</td>
<td>171.1</td>
</tr>
<tr>
<td>Manchester</td>
<td>86.2</td>
<td>79.1</td>
<td>165.4</td>
</tr>
<tr>
<td>Belfast International</td>
<td>0.5</td>
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<td>Luton</td>
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<td>36.6</td>
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<td>Prestwick</td>
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</tr>
<tr>
<td>Kent International</td>
<td>0</td>
<td>28.4</td>
<td>28.4</td>
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<tr>
<td>Edinburgh</td>
<td>0.8</td>
<td>18.5</td>
<td>19.3</td>
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<tr>
<td>Birmingham</td>
<td>11.9</td>
<td>1.7</td>
<td>13.6</td>
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<tr>
<td>Coventry</td>
<td>0</td>
<td>7.5</td>
<td>7.5</td>
</tr>
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</table>

Note: Table 3.1 includes airports which handled more than 7,000 tonnes of freight in 2007. There are a further 37 airports handling less than 7,000 tonnes.

Source: Data from UK Airport Statistics, CAA website, annual statistics for 2007.

3.8. In addition to variation in the size and major uses of airports, there are differences in the location of airports and the distance between airports and major population centres. In particular, many of the larger airports are concentrated in the South East of England. Figure 3 shows the location of airports in the UK which handled more than 1 million passengers in 2007.
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Figure 3 – Location of airports in the UK

Source: Department for Transport, Transport Statistics.
Competitive interaction between airports

3.9. Airports compete with each other in two ways. Directly, by attracting airlines to provide routes from their airport to serve potential passengers who want to use the airport, and indirectly by affecting airline fares which attracts passengers to use their airport. Airports have a direct contractual relationship with airlines, but generally only an indirect relationship with passengers, although passengers do purchase some services such as car parking directly from the airport. Therefore, airports are not directly competing to attract passengers in the first instance, but the attractiveness of an airport to passengers will be crucial to attracting airlines to use the airport.

3.10. As well as differences in the size and location of airports, there are differences in the competitive interaction between airports. There is evidence that a number of airports enjoy a strong market position that amounts to substantial market power or dominance. In particular, Heathrow airport differs to other airports due to its status as a major transfer (connecting) hub and this status confers some ability to set prices above the competitive level (although this is currently constrained by price cap regulation). However, there are many other airports in the UK which can be described as operating in a broadly competitive environment.

3.11. The CAA has carried out two reviews of regional airports and its results indicate that these airports are likely to face strong competitive pressures. The CAA refers to competition between neighbouring regional airports as being accepted by the industry as a ‘given’. Key results that support this view include:

- A greater variety of routes and rising quantity of scheduled services and mix of services at the regional airports;
- The bulk of regional air services provided by Low Cost Carriers with evidence of fierce competition in the airline activities at these airports, including increasing churn and switching (or willingness to change routes to find the highest returns);
- Greater levels of separate ownership amongst the regional airports;
- Greater commercial outlook amongst the regional airports, with more involved and challenging airline/airport negotiation over contracts and falling airport charges; and
- More fostering of links with hubs outside the EU by regional airports and a reduced focus on Heathrow.

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3.12. Figure 3.4 shows the total number of passengers at the fastest growing regional airports over the last ten years.

![Figure 3.4 - Passenger numbers at UK regional airports](image)

Source: Data from UK Airport Statistics, CAA website.

3.13. David Starkie, in a paper written in 2008, provides an example of the competitive nature of the industry by examining Liverpool and Manchester airports. In particular, he notes the rapid rise of traffic at Liverpool airport over the last decade and the corresponding decline in charter traffic at nearby Manchester airport. In the early summer of 2006, easyJet had 15 routes from Liverpool airport, 13 of these had parallel competition from other airlines operating out of Manchester airport. Ryanair had 20 routes from Liverpool airport with 8 of these experiencing parallel competition from airport services at Manchester airport. Starkie surmises that probably as a reflection of this competition, Manchester airport’s share of UK air traffic has changed little in recent years in spite of a strong general growth in market share at airports outside London and the South East. For its Market Investigation the Competition Commission has also carried out analysis of competitive interactions between a range of UK regional airports, which demonstrate strong, although somewhat variable, competitive interactions.15

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15 See papers at http://www.competition-commission.org.uk/inquiries/ref2007/airports/working_papers_september.htm
3.14. The different levels of competition between airports, added to their differences in size and location, indicates that the sectoral regulator should be given a flexible range of tools in order to ensure the best outcomes for passengers. For example, while an airport such as Heathrow may require a highly specified licence with price and quality controls (we discuss this further in chapter 4), an airport such as Liverpool may require little in the way of licence conditions, above those requirements set out in the EU Airport Charges Directive. The new regulatory framework will aim to deliver this flexibility.

The airline sector

3.15. The regulatory framework for the aviation sector focuses on airports because the airline sector is seen to be competitive and therefore delivering good outcomes to passengers. In particular, the liberalization of the EU air transport market in the 1990s has meant that the industry has evolved from a system of long-established state-owned carriers operating in a regulated market to a dynamic, free-market industry. This process has led to the rise of the Low Cost Carriers (LCC) for passenger travel and has also reduced the costs of transporting freight. The conduct of airlines will continue to be governed by general competition law and the safety regulation carried out by the CAA.

Developments in economic regulation

3.16. In the September 2008 submission to the Competition Commission, the DfT noted that when economic regulation was initially established in the UK (telecoms in 1984, and airports and gas in 1986), it was intended primarily to be a means of ensuring that private sector monopolies did not make excessive profits, at least until more vigorous competition developed. In general, more pro-active efforts to promote competition occurred primarily in the 1990s, e.g. gas and electricity retail competition, with to some extent the exception of telecoms. In the airports sector the more limited focus on promoting competition is also reflected in an absence of any duty for the CAA to promote competition between airports or to have regard to competition between airlines. Amongst the other notable developments in economic regulation since 1986 have been:

- **The structure of regulators** – Most UK regulators now have a board structure based on a combination of Executive and Non-Executive members. The Pilling review of the CAA supports such a Board structure.

- **Social and environmental roles** – There has been an increasing role for regulators in helping to meet Government social and environmental objectives.
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- **Competition in a wider range of activities** – There has been a process of discovery by regulators and industry, which has extended the scope for competition to areas previously considered to be core monopoly activities.

- **More varied and complex financial structures** – Regulated companies have increasingly moved to a more highly geared financial structure, which has raised new challenges for regulators, particularly how to protect consumers from the associated risks.

- **Generic competition law** – Competition law with generic application to all sectors of the UK economy has been introduced (the Competition Act 1998). The Office of Fair Trading, and other regulators with concurrent powers, are charged with enforcement of competition law and have discretion as to enforcement decisions and practice.

3.17. Annex 3 provides a summary of the existing regulatory regime for UK airports.

**Conclusions**

3.18. The UK airport sector is characterised by vibrant passenger and freight sectors that have shown strong historic growth in volumes over many years. This has led to a substantial expansion and growth in regional airports, together with continued passenger growth at the large London airports and Manchester airport. Whilst growth may be affected by the current economic downturn, over the longer-term we expect the sector to continue to expand. In addition to strong historic growth the types of airlines using airports has also changed with the growth of LCC’s. The different users of airports are likely to have different requirements in terms of the airport services they require, and these requirements may change further in the future. This implies that any regulatory framework needs to give the regulator sufficient flexibility to deal with the particular circumstances of each airport, rather than having a one-size-fits-all approach.

3.19. The changes to other utility regulation frameworks since 1986 also suggests that there is scope for bringing the framework for airports closer to best practice. This includes a greater focus on the interests of passengers and a greater focus on promoting competition where that can deliver the best outcomes for passengers.
4. The need for Government or regulatory intervention to address the existence of substantial market power or dominance

Introduction

4.1. This Review is focused on how best to achieve the Secretary of State’s objectives, which are set out in paragraph 2.4. In this context, the Review has been particularly focused on how the interests of passengers can best be furthered. We consider that competition between airports and airlines, and more generally in the provision of aviation services, should generally lead to good outcomes for passengers (the expansion of regional airports, together with lower prices and greater choice of destinations, provides such evidence). Therefore, this Review focuses on identifying those aspects of the airport sector where market forces might not be expected to work effectively to further passengers’ interests.

4.2. We believe it is very important to establish the rationale for the new regulatory framework and other potential policy interventions, as without clarity about the rationale there is a significant risk that the most appropriate regulatory framework and policy interventions are not identified. The rationale provides the basis for understanding whether and when circumstances may arise where the operation of the market for airport services, underpinned by general competition law, may not lead to appropriate outcomes, and in particular economically and socially desirable outcomes. We consider that the regulatory framework, together with wider Government policy in the aviation sector, should be aimed at maximising consumer benefits and welfare to deliver socially desirable outcomes. This is expected to be best achieved through well functioning competitive markets, but there are likely to be circumstances where the presence of substantial market power or dominance, or other externalities, mean that market mechanisms alone will not deliver socially desirable outcomes.

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16 The Office of Fair Trading’s website includes guidance about how the concepts of market power and dominance should be assessed.
4.3. We are committed to applying the Better Regulation principles. These principles help ensure that if a new regulatory framework and other potential policy interventions are required, the most appropriate interventions are chosen. A key part of ensuring that we follow the Better Regulation agenda is to consider whether any interventions could have unintended consequences that outweigh their potential benefits.

4.4. In this chapter we consider the strength of the potential rationale for Government or regulatory intervention as a result of the presence of substantial market power or dominance at UK airports. The next chapter considers the potential rationale for Government or regulatory intervention as a result of the presence of externalities that affect the UK aviation sector.

4.5. In the remainder of this chapter we:

- Summarise the DfT’s initial views on the rationale for intervention from the September 2008 submission to the Competition Commission’s Market Investigation with regard to the presence of substantial market power or dominance at UK airports.

- Summarise the further analysis and information that has been received since September 2008.

- Consider the extent to which the presence of substantial market power or dominance at UK airports provides a rationale for intervention.

- Set out the key conclusions of the Review regarding the rationale for intervention as a result of the presence of substantial market power or dominance at UK airports, with chapters 6 to 10 explaining the interventions proposed.

Initial conclusions from the DfT’s September 2008 submission to the Competition Commission

4.6. The DfT’s September 2008 consultation and response to the Competition Commission (the ‘submission’) explained in more detail the key issues that underpinned each of the Secretary of State’s policy objectives. The submission explained that the DfT shared the Competition Commission’s concerns about the quality of the passenger experience, particularly at BAA’s London airports, where substantial market power or dominance were present. It also recognised that different passengers will have different views about what constitutes a good experience, e.g. business passengers have different needs from those visiting friends and family or travelling for leisure. Promoting competition that delivers choice for passengers was therefore likely to be a key feature of any new regulatory framework. The DfT also

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17 For more information see http://www.berr.gov.uk/bre/
18 Consistent with the criteria currently used to decide whether an airport should be designated or de-designated for the purposes of setting a price cap under the Airport Act 1986, we have adopted the benchmark of substantial market power or dominance to consider whether an airport may have the ability to act in ways that are anti-competitive to the detriment of passengers and competitors.
recognised that a “one size fits all” approach to the regulatory framework was not likely to be appropriate given the very different issues at UK airports, ranging from the hub nature of Heathrow airport, which contributed to its strong market position, to the much smaller scale operations at many regional airports. Overall, the DfT considered that the passenger experience can be most improved by increasing reliability and reducing, where possible, end-to-end journey times. This particularly applied to airports in the South East of England with substantial market power or dominance.

4.7. Investment in new and enhanced capacity when it is required is crucial to ensuring that the aviation sector is able to deliver a good passenger experience and contribute to UK economic growth and productivity. The Competition Commission highlighted the impact of a lack of capacity expansion in the South East of England on the passenger experience. In particular, the Competition Commission was concerned that a lack of sufficient capacity expansion in the South East of England had resulted in congestion at major airports. The Government has already set out in the Air Transport White Paper (ATWP) – and subsequent updates – its views about the types of investment that would meet these objectives.

4.8. The Secretary of State also noted when launching the Review that major changes had occurred in the UK and international aviation sector since the current regulatory framework was established through the Airports Act 1986. There have also been major changes to the way in which utility regulation is implemented. These changes were discussed in the Department’s September 2008 submission to the Competition Commission.

4.9. In the September submission to the Competition Commission, the DfT concluded that with regard to a rationale for intervention based on market power considerations:

- Given the analysis undertaken up to then by the Competition Commission for its Market Investigation (set out in its Provisional Findings) including regarding the poor quality of some passengers’ experiences and the impact on investment, the conclusions of the recent price reviews for Heathrow and Gatwick airports (which addressed the potential pricing power of the airports), the Secretary of State’s decision to retain the designated status of Stansted airport, and many stakeholders views, there was likely to be a rationale for regulating some airports including some or all of Heathrow, Gatwick and Stansted airports at least for some period of time into the future.

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Reforming the framework for the economic regulation of UK airports

- Given the evidence about the performance of regional airports in the UK (including substantial increases in destinations served and real reductions in prices for passengers) and the Secretary of State’s decision to de-designate Manchester airport23, the DfT considered initially that there was unlikely to be a strong rationale based on a lack of competition for regulation or other policy interventions for many regional airports in the UK. It noted that there may be some scope for further deregulation of the provisions regarding some regional airports. The DfT noted that the Competition Commission had raised concerns about the market power of Aberdeen airport.24

4.10. At that stage the DfT had not fully considered the potential impact on competition between UK airports, and the presence of substantial market power or dominance, if the divestment remedies set out in the Competition Commission’s Provisional Findings were implemented. The DfT noted that the Competition Commission had provisionally indicated that even following divestment by BAA of two of its three main London airports, there might still be a need for ex ante price and service quality regulation of all three airports until there was sufficient new capacity to promote competition between the airports. The Competition Commission further indicated that it expected Heathrow airport to require ex ante regulation for the foreseeable future given its market position. Therefore, the provisional conclusions of the Competition Commission’s Market Investigation were unlikely to fully remove the need for ex ante regulation to address the potential consequences of the presence of substantial market power or dominance.

4.11. These conclusions were reached after considering the potential role of competition law to adequately address any concerns about substantial market power or dominance. The DfT concluded that while competition law may provide some influence on behaviour and deter certain undesirable behaviour, it was not confident that the EC Treaty Article 82 or Competition Act 1998 Chapter II prohibitions (or the relevant provisions of the Airport Act 1986) would effectively hold and encourage airport operators to specific standards of behaviour regarding passenger service, the timing or location of investment or environmental impact reduction.

4.12. The DfT explained that different types of regulation or policy interventions may be more likely to be appropriate for different types of rationales, although each case must be evaluated on its own merits. For example, independent regulation has generally been used to address potential adverse impacts from market participants with substantial market power or dominant positions.

24 The Competition Commission’s Provisional Decision on Remedies proposes some ex ante price and investment regulation of Aberdeen airport because of its concerns about the local market power held by the airport. We note, however, that the CC has recently launched a consultation seeking views on alternative remedies. Under the proposed regulatory framework it will be for the CAA to consider the need for such provisions in the longer term within the framework of the licensing regime. An airport would need to meet the criteria for a Tier 1 licence (see chapter 7) to be subject to ex ante price and service quality regulation.
New evidence and analysis

4.13. Since the DfT’s September 2008 submission to the Competition Commission a range of further information and analysis has become available that informs consideration of the rationale for intervention given the presence of substantial market power or dominance at some UK airports. The additional information and analysis is briefly discussed in turn below, and generally reference is made to sources that provide further detail.

CAA survey on passenger experiences and the focus group feedback

4.14. To inform the DfT’s wider view about the quality of the passenger experience at UK airports, and to help inform this Review, the DfT commissioned two pieces of research. First, the CAA undertook two surveys last year of passengers’ experiences at UK airports. Second, the DfT commissioned a set of focus groups and interviews to gain a more in-depth and qualitative view about passengers’ experiences. The key results from these two pieces of evidence are summarised below.

CAA’s surveys

4.15. In general, the results from the surveys were positive and suggested that UK airports typically provide passengers with a good experience over. According to the ORC survey, 80 per cent of respondents using the four largest UK airports (in terms of passenger volumes) were satisfied with the through-airport experience, although respondents tended to be less satisfied with various pinch points at the airport where multiple service providers were involved, notably baggage. Similarly, 80 per cent of respondents said they were likely to recommend their UK departure airport to a friend. Furthermore, the majority of respondents felt their experience at the UK airport was either similar to that they had at the destination airport (40 per cent) or better (32 per cent) rather than worse (25 per cent). It is important to note that satisfaction levels will depend on passengers’ expectations and in general operating conditions over the period of the survey were quite good.

4.16. The results suggested that airport location, flight times and price of ticket were important determinants of flight choices by passengers. The most commonly cited best feature of an airport was its location and convenience, with 29 per cent of respondents identifying this feature. Location/convenience was the most commonly cited major factor in choosing flights, with 70 per cent of passengers identifying this feature. There was a consistent mismatch between passengers’ expectations of minimum wait time and experience in reality. On average, it seems that passengers spent more time waiting for their baggage than proceeding through security, check-in or immigration.

4.17. Passengers felt that there were good levels of information for the different stages of travel at the airport, apart from queue lengths. Relative to other parts of the airport experience, significantly fewer passengers felt there was sufficient information about queue lengths.
4.18. The results suggested that approximately 4 per cent of passengers each year complain to the airport or other official organisations about their airport experience. This is more than the amount that complained about their flight or ticket purchase. It is not clear whether this represents a high percentage and indeed what would constitute a comparable industry. Air travel and plane flights were rated as a “middling” market by consumers in BERR’s recent consumer conditions survey that compared 45 different sectors. More generally this survey provides evidence that there is room for improvement in the service provided to passengers compared to other sectors.

4.19. No airport stood out as performing particularly poorly or to a consistently high standard across the aspects surveyed. Further details on the performance of specific airports included in the two surveys can be found on the DfT website.

**Focus groups**

4.20. The DfT commissioned 10 focus groups and in-depth interviews across five locations in the UK to examine passengers’ experiences at airports. Information was gathered from 78 respondents (including both business and leisure passengers) who had used 25 different UK airports during the preceding year. Respondents generally articulated their priorities in terms of three principles – the demand for airports to provide a more passenger focused service that allows for personal control and ensures fairness.

4.21. Beyond this, the research grouped the issues affecting positive passenger experience into the six themes below, broadly in order of importance:

- End-to-end reliability and efficiency (smooth and seamless journeys, lack of delays & queues)
- Information and communication (better and more accessible flight information, information on airport and security requirements)
- Customer care (proactive & friendly staff, taking responsibility for issues)
- Facilities and entertainment (meeting diverse passenger needs, availability of services out-of-hours)
- Airport design and maintenance (ambience, cleanliness and accessibility)
- Cost (fair pricing of goods & services)

4.22. Respondents viewed the through-airport experience as one part of a wider end-to-end journey; this mirrors the Department’s approach to journey definition. Journey reliability across the entire end-to-end journey was identified as a priority for respondents in order to reduce the risk of knock-on problems or delays in later journey stage. Respondents generally had quite low expectations of the through-airport experience, particularly in

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terms of delays and queues, although actual experiences were often not so problematic. Respondents also felt that some minimum level of service should be provided irrespective of the ticket price.

4.23. Respondents identified areas which were considered to be generally good, as well as aspects where performance was felt to be more variable. In terms of improving airport experience, the research pointed to a number of priority areas which were considered to be consistently poor. These included customer care and problem resolution; provision of flight information and handling of delays; management of passenger flows through the airport; assistance for people with non-visible disabilities; availability of quiet spaces; and facilities and seating at departure gates. The study did highlight, however, that different aspects of the airport experience were important for different passenger types; for example, respondents who had travelled for business tended not to have the same priorities as those who travelled for leisure, and other respondents, such as those with a disability or who had flown with children, again had specific requirements. Improving passenger experience across airport users will therefore need to consider these diverse needs.

4.24. Improving the passenger experience at UK airports depends on achieving a better understanding of passengers’ needs. This research revealed that the overall quality of airport experience depended on a web of interrelated variables and that respondents’ priorities varied according to their characteristics, circumstances and reason for travel. The evidence provided an initial picture of key respondent priorities that airports could address, and has also highlighted the need to take account of ‘softer’ factors which cannot easily be measured by typical performance indicators. We discuss these issues further in chapter 9.

4.25. Further details of this research can be found in the full report Understanding Airport Passenger Experience published alongside this consultation.

Major investment projects

4.26. Since September 2008, the Government has given planning permission for an increase in the maximum number of air traffic movements from 241,000 per year to 264,000 per year and the number of passengers using Stansted airport from 25m to 35m a year. In January 2009, the Government confirmed its support for a third runway and accompanying terminal infrastructure at Heathrow airport. Government support is limited to a maximum of 125,000 extra flights a year – just over half the additional capacity consulted on – to be reviewed in 2020; conditional upon a legally binding mechanism to ensure that additional capacity is only released if noise and air quality limits are met. Before BAA can develop the third runway and associated infrastructure it will need to obtain planning permission from the relevant planning authority. We discuss further details of these environmental limits and how they will apply to Heathrow airport in chapter 5.

27 European Regulation EC No: 1107/2006 on the rights of disabled persons and persons with reduced mobility when travelling by air came into force on 26 July 2008. This makes it a legal obligation, for all European airports to organise the provision of services necessary to enable disabled and reduced mobility passengers to move through the airport, board, disembark and transit between flights.

28 http://www.dft.gov.uk/pgr/aviation/airports/decisionletters/stansted/
4.27. The Government has recently published a detailed Heathrow Impact Assessment, alongside Government decisions on additional capacity at Heathrow. This sets out costs and benefits of additional runway capacity at Heathrow. The assessment shows that the economic case for expansion remains positive, as set out in the Air Transport White Paper (2003). The commercial risk for the project will be for BAA to manage.

The Competition Commission’s Market Investigation

4.28. In December the Competition Commission published its Provisional Remedies for its market investigation of BAA’s UK airports. In broad terms the Competition Commission has endorsed the draft remedies it published alongside its Provisional Findings in August 2008. In particular:

- It has proposed the divestment by BAA of two of its three London airports, which are expected to be Gatwick and Stansted airports, and the divestment of either Edinburgh or Glasgow airport, with a preference for Edinburgh airport. It is consulting on the more detailed arrangements for implementing divestment.
- It has set out its views on a range of key elements of the new regulatory framework for UK airports. This includes supporting a primary duty focused on passengers’ interests, but recognising that airlines and passengers’ interests often align as well as a licensing regime and the Competition Commission as an appellate body for CAA price control decisions.
- It is proposing undertakings for Heathrow airport, and consulting on similar undertakings for Gatwick and Stansted airports before the conclusions of the DfT’s Review of the regulatory framework are implemented. These undertakings would be particularly focused on improving the consultation process between the airport and airlines to make constructive engagement work more effectively.
- It is proposing undertakings on Aberdeen airport to implement an ex ante price cap, with the level of the price cap linked to the investment undertaken at the airport.

4.29. We have been working closely with the Competition Commission and welcome their analysis and views about the future regulatory framework for UK airports. We also note that many of its views align with those of the Expert Panel. We consider that the Competition Commission’s analysis supports a view that there is a rationale for regulating Heathrow airport (potentially over the longer term) and Gatwick and Stansted airports (at least until there is evidence of substantially more competitive pressure than is

29 http://www.dft.gov.uk/pgr/aviation/heathrowconsultations/heathrowdecision/impactassessment/
30 http://www.dft.gov.uk/pgr/aviation/heathrowconsultations/heathrowdecision/decisiondocument/decisiondoc.pdf
33 We note that the Competition Commission has recently launched a consultation seeking views on alternative remedies in relation to Aberdeen airport.
The need for Government or regulatory intervention to address the existence of substantial market power or dominance currently the case) given their market position. The Competition Commission’s analysis for Aberdeen airport raises the question as to whether any other regional airports are in a similar position. As discussed in the next section, the consideration of the market position of UK airports will be a matter for the CAA in the first instance under the proposed new regulatory framework.

4.30. We have also noted that the Competition Commission is concerned that there has historically been insufficient investment in new capacity at BAA’s airports in the South East of England. The Competition Commission has provisionally identified a number of factors that have contributed to the lack of investment in new capacity. This includes the lack of competitive pressures faced by BAA due to its common ownership of the three main London airports, which the Competition Commission considers has reduced its incentive to push for capacity expansion as fast as would have occurred in a broadly competitive market. Amongst the concerns of the Competition Commission is BAA’s willingness to accept limits on the further expansion of some airports as part of securing planning permission for developments. The Competition Commission has also been concerned that aspects of the regulatory regime have not worked as well as they could in promoting further investment, including its concerns about the operation of Constructive Engagement. Furthermore, the Competition Commission raised concerns about the impact of the planning regime (before the Planning Bill became law) and the degree of specification about investment in the ATWP. The Government’s decisions to support an expansion of passenger numbers at Stansted airport and a third runway (subject to strict environmental conditions) at Heathrow airport demonstrate the Government’s commitment to allowing new capacity to be developed if it is socially desirable and the airport operator considers there is a commercial business case. The Government also supports the Stansted G2 project, which would add a second runway and additional terminal capacity.

4.31. We recognise that a number of stakeholders have commented on and questioned aspects of the analysis and provisional remedies proposed by the Competition Commission, and we will consider the Competition Commission’s response to these comments in its Final Report.

Responses to the DfT’s September 2008 submission to the Competition Commission

4.32. A summary of the issues raised in response to the DfT’s submission to the Competition Commission is published alongside this document. With regard to the rationale for intervention to address the presence of substantial market power or dominance at UK airports, the main points raised were:

- Broad agreement amongst those who commented that Heathrow airport’s market position was such that it was likely to be subject to ex ante regulation for some period into the future.
- Less agreement that this would necessarily be the case for Gatwick and Stansted airports, particularly following divestment.
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- Concern from a number of respondents that regulation should not be extended unnecessarily to regional airports that were already delivering good outcomes for passengers.

- The CAA needed to be given a flexible set of tools to determine the appropriate form of regulation over time and on a case by case basis for airports. The CAA's powers needed to be subject to suitable checks and balances.

Evidence about and impact of the presence of market power

4.33. The DfT considers that well functioning competitive markets are the best way to protect passengers’ interests and to promote a dynamic aviation sector in the UK that contributes to the growth and development of the whole economy. We consider that competition between airports can and does happen within the UK to the benefit of passengers. The large growth of regional airports in the UK in recent decades is perhaps the best illustration of the potential for competition between airports to deliver substantial passenger benefits. Detailed analysis by the CAA and the Competition Commission has illustrated the nature of these benefits, which include substantially expanded choices of destinations and lower prices in real terms for passengers. The DfT’s decision to de-designate Manchester airport, which will have effect from April this year, is also based on a strong recognition of the competitive interactions between Manchester and Liverpool airports in particular in delivering better services, choice and lower prices for passengers.34

4.34. However, it is much less clear that competition between airports in the South East of England has developed to the benefit of passengers. The Competition Commission’s Market Investigation has discussed extensively concerns that insufficient capacity expansion and poor quality of service have led to consumers using the South East airports being poorly served. The Competition Commission is concerned that the lack of competitive pressures faced by BAA has reduced its incentives to invest in sufficient capacity to meet demand and to respond adequately to the needs of passengers. The Competition Commission does not consider that the regulatory framework has sufficiently addressed these issues to date. The Competition Commission has also reached adverse public interest findings with regard to Heathrow, Gatwick and Stansted airports at the recent price control reviews, which have led to the CAA implementing or proposing to implement service quality rebate schemes. Adverse impacts of market power might be expected to manifest themselves in three broad ways:

- Prices that are higher than would prevail in a well functioning competitive market. This is unlikely to be an issue for the BAA airports in the South East of England because they are currently subject to price cap regulation, although the potential for it to happen would be an important element of assessing an airport’s market power.

34 "Air Services at UK Regional Airports, An Update on Developments", CAA, November 2007. Available at http://www.caa.co.uk/docs/33/CAPT775.pdf
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- Poor service quality or a lack of variety in the service quality offered. As noted above this has been a concern of the Competition Commission.
- Insufficient investment because the airport wants to restrict supply. As noted above this has been a concern of the Competition Commission in its Market Investigation, where it considers that the lack of competitive pressures on BAA have not been outweighed by the role of regulation to ensure sufficient investment in new capacity.

We discuss further below some of the evidence about service quality and investment outcomes. The detailed work of the CAA and the Competition Commission for the price control reviews of Heathrow, Gatwick and Stansted airports help to illustrate the issues regarding price levels.

**Service quality outcomes**

4.35. The passenger surveys and focus groups discussed above illustrate that a lot of passengers have relatively positive airport experiences. This may partly reflect a relatively benign operating environment in 2008 when the surveys were undertaken. It may also reflect the relatively low expectations that air passengers have of the airport experience and the feedback from the focus groups provides evidence to support this view. While passenger requirements are not homogenous, there is evidence that most passengers expect a similar basic level of service based on limited delays. Figure 4.1 compares performance data on the percentage of flights leaving within 15 minutes of their scheduled departure time at different UK airports and shows a higher proportion of flights left Heathrow and Gatwick airports more than 15 minutes late in 2007 than at any other UK airport – around 38% in the case of Heathrow airport compared to 27% at Manchester airport. The proportion of flights being delayed by more than 15 minutes at Heathrow and Gatwick airports has been increasing since 2003.

4.36. Moreover, the CAA identify that Heathrow’s performance in terms of airport delay is worse than two of its main European hub competitors (Amsterdam Schiphol and Paris Charles de Gaulle) and on a par with Frankfurt. This performance is likely to underpin stakeholder concern that delays and poor reliability at Heathrow airport are adversely affecting the competitiveness of the UK economy.
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4.37. The Competition Commission considers that there is strong evidence that where airports have substantial market power or dominance passengers’ interests are unlikely to be adequately protected without some form of regulatory intervention. An interpretation of the available evidence does support the Commission’s view, but in any event it is clear that for whatever reason passengers have not been getting the service levels that you might expect in a more competitive market. It is less clear that there is a rationale for intervening to address service quality at airports without substantial market power. Such intervention could be justified if:

- There is a substantial asymmetry of information between passengers and airports about the quality of the passengers’ experience, such that passengers would make significantly better choices if they had better quality information about the experience they are likely to receive at different airports.

- The nature of the interactions between organisations to deliver a good quality of service at airports is such that co-ordination difficulties might occur that reduce significantly the quality of service for passengers.

Issues have also been raised with the DIT about the importance of maintaining regional connectivity, particularly to Heathrow airport.
Asymmetry of information

4.38. Almost all markets are characterised by differences in the knowledge and information of market participants. It is frequently argued that better information for market participants leads to better decisions being made and therefore improved market outcomes. For airports, in the case that passengers use them relatively infrequently, it might be argued that they have limited information on which to evaluate the quality of the experience they are likely to receive.

4.39. It is important to note that many travellers, particularly business travellers, will regularly use a range of airports and so represent relatively informed consumers. There can also be some direct benefits to airports from providing a higher quality of service, e.g. increasing the time passengers are able to spend in the departure lounge through reduced queues might increase commercial revenues, although over time passengers might come to expect reduced queues and therefore arrive later at the airport. Finally, to the degree airlines’ preferences are aligned with those of passengers, they may act to help ensure appropriate quality of service.

4.40. The evidence from CAA surveys and the DfT’s focus groups suggests that while passengers do, to some degree, consider a range of airports when making their travel plans, the expected quality of service at the airport is not a key factor in their decisions, although it does have some influence. Instead, passengers are more likely to focus on the location/ convenience of the airport, flight times and ticket price. For some passengers in the UK the proximity of their local airport, particularly if it has a reasonable range of destinations, may make the opportunity cost of using another airport quite large.

4.41. It is not clear that there is a compelling economic rationale for requiring all airports in the UK (discussed above) to publish quality of service information. Given the ambiguous evidence about how much passengers would value this information, it would probably only be appropriate to require airports to collect the information if the costs of doing so were very low, and therefore likely to be less than the potential benefits. Therefore, we would welcome views on the costs and benefits of collecting information about service quality systematically from all UK airports, and in particular whether there would be sufficient benefits to outweigh the costs.

Co-ordination benefits

4.42. The end-to-end journey for airline passengers involves a range of different organisations interacting, including those providing transport to the airport, the airlines, the UK Border Agency, the airport and providers of facilities within the airport. Many of these organisations need to co-ordinate the provision of their services to ensure that passengers receive a good quality of service, e.g. the UK Border Agency needs to have staffing rotas that are consistent with airline arrival schedules. Where organisations have a clear

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We are aware that such reporting requirements are currently a feature of the current service quality regimes at Heathrow and Gatwick airports. We are also aware that ‘service level agreements’ announced in the 2008 Budget for the ‘busiest’ airports will require published waiting time targets, with reporting against them.
profit maximising incentive, and are operating in a competitive market, such
coordination might be expected to arise through the incentives faced by
the market participants. Concerns may arise where some market
participants have substantial market power or dominance, or lack a clear
profit maximising incentive. However, there is evidence even in such
circumstances of co-ordination, e.g. the Home Office and BAA have
recently announced initiatives to reduce border waiting times at Heathrow
airport.37 We discuss further initiatives taken forward by the Borders Agency
to improve the passenger experience in chapter 9.

4.43. If co-ordination failures were large enough then in principle an outside
organisation might be able to improve overall outcomes by providing the
coordination service. Although they are fulfilling a statutory role with
authority from the Secretary of State, an example from the aviation sector is
the use of Airport Co-ordination Limited (ACL) to manage slot allocation at
congested airports in the UK.

4.44. The CAA has recently assessed the effectiveness of coordination between
different service providers at Heathrow, Gatwick, Stansted and Manchester
airports. This was in response to advice requested by the Secretary of State
(under s.16 of the Civil Aviation Act 1982) on how to improve the through-
airport experience. They found significant scope for the CAA to play a
greater role facilitating co-ordination between the different service providers
at Heathrow, Gatwick and Stansted airports to improve the passenger
experience in relation to airline departure times, planning for disruption,
baggage delivery and staff availability.38 This approach received broad
stakeholder support. The CAA identified that co-ordination was generally
working well at Manchester airport and so no further action was deemed
necessary. This evidence supports the view that airports with market power
lack the incentives to devote resources to ensure airport services align with
the needs of users. From the evidence about the performance of regional
airports it is not clear that there is compelling evidence of co-ordination
failures at airports without market power, and there is certainly not currently
evidence that an outside organisation would be able to create benefits more
than any costs incurred or unintended consequences that could arise.

4.45. As discussed in subsequent chapters, we are proposing to give the CAA
the power to intervene to improve co-ordination between the different
parties operating at an airport to improve the passenger experience. It will
be for the CAA to decide when it should use this power, and in particular,
to consider whether any steps it takes are likely to improve the passenger
experience without leading to significant unintended consequences.

Regional connectivity

4.46. Some stakeholders have raised their concerns about the reduction in air
services between regional airports and Heathrow. This contrasts with the
general increase in the range of scheduled destinations that are served from
UK airports that has followed from the liberalisation of air services and
increased competition between airlines.

faster-border-controls (accessed 8 December 2008).
38 Service providers included the airport operators, the airlines and their ground handlers, and border control.
4.47. The crowding out of regional services from capacity constrained Heathrow is unlikely to have an adverse impact on the regions providing regional connectivity is maintained via alternative airports. Using Edinburgh-Heathrow as a case study, DfT found that while Heathrow services have declined to some degree, regional connectivity has been maintained via alternative London and European hub airports. At some regional airports, such as Durham Tees Valley and Leeds Bradford, the service to Heathrow airport is the sole link to London airports. If all London airports or European hubs were to become capacity constrained to the extent that regional connectivity declined, then the benefit of an efficient use of slots might not out-weigh the costs to the regions. However, under this future scenario existing provisions, such as Public Service Obligations, could be imposed to ensure adequate services between two cities or regions (but not individual airports) are maintained.

4.48. The DfT published guidance in 2005 on protecting regional access to London via Public Service Obligations (PSOs), but no applications to impose PSOs on London routes have since been received indicating that regional connectivity is perhaps not such a significant issue, although concerns about regional connectivity are raised with DfT from time to time. Given this measure, we do not believe additional policy interventions, either through the regulatory framework or otherwise, are necessary. This is supported by comments received from the CAA who expressed the view that the maintenance of routes between regional airports and any particular airport should not be an obligation of the regulator. The CAA further noted the Government’s capacity to impose PSOs on specific routes where necessary. We are also committed to investigating further the potential for high speed rail links to reduce the need for short haul flights into Heathrow airport.

Investment outcomes

4.49. The Competition Commission’s Provisional Findings stated that BAA has spent on average £690 million a year at its seven airports since privatisation in 1987 and £960 million a year over the past ten years (in 2006/7 prices). The scale of current capital expenditure plans is a major reason for the increased charges that the CAA have authorised at London airports in recent price control decisions. Notwithstanding the substantial investment since privatisation, the Competition Commission’s Provisional Findings and Provisional Remedies are critical of BAA’s efforts to expand capacity at its South East airports.

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39 Airports form one part of an end-to-end journey to a final destination.
40 BMI announced in February 2009 that they are to withdraw services from Durham Tees Valley and Leeds Bradford to Heathrow from 28 March 2009.
41 PSO can be between domestic cities or cross-border within EU. Thus, they could be used to ensure access to European hub airports.
42 PSO’s have been imposed on routes serving remote communities in the highlands and islands of Scotland as well as Wales.
4.50. The scale of historical investment illustrates that although capacity at airports in the South East of England is currently scarce relative to evidence about demand, there has been significant investment at UK airports since privatisation. Major investments at designated airports include a second terminal at Gatwick airport, a second runway at Manchester Airport and Terminal 5 at Heathrow Airport. There has also been significant investment at regional non-designated airports in the UK, including bringing previously little used or unused airfields into service for passengers and freight.

4.51. Relative to the growth in demand for air travel, particularly in the South East of England, the investments outlined above have not been sufficient to prevent substantial congestion and deterioration in the passenger experience at some airports. For example at Heathrow airport the CAA estimated that peak utilisation rates reached 98.5% in 2007-08 with flow rates approximately 97 to 98% through the scheduling season. At Gatwick airport flow rates were marginally lower and more seasonal with average utilisation levels at around 95% during the summer season (and up to 99% in summer peak) and around 88% during the winter season.

4.52. Evidence from the DfT’s air passenger forecasts suggests that demand is set to rise significantly over the coming three decades. The charts below are taken from the DfT’s latest projections of passenger demand. Figure 4.2 shows that, if not constrained by airport capacity, air travel demand at UK airports is forecast to grow strongly under the central case, from 241 million passengers per annum (mppa) in 2007 to 464mppa in 2030 (within the range 417-500mppa).

Figure 4.2 – Unconstrained demand forecast

Source: UK Air Passenger Demand and CO2 Forecasts 2009, DfT.
The need for Government or regulatory intervention to address the existence of substantial market power or dominance

4.53. However, continued demand growth would eventually become constrained by airport capacity. Figure 4.3 shows that, even with the additional capacity supported in the White Paper, capacity constraints limit the 2030 central demand forecast to 455mppa (within the range 410mppa to 480mppa).

**Figure 4.3 – Constrained demand forecast**

![Graph showing constrained demand forecast](image)

Source: UK Air Passenger Demand and CO₂ Forecasts 2009. DfT.

4.54. The continued growth in passenger demand anticipated in these figures suggests that commercial airports will find investment in capacity attractive in the near future. Predicting airport decisions in respect of the commercial benefits and costs of capacity investment is complicated when airports have substantial market power or dominance. In these circumstances it is not clear that even where expansion is commercially viable that airports will invest, and this concern is at the centre of the conclusions reached by the Competition Commission in its Market Investigation. These airports may consider it more profitable, or less risky, to retain capacity constraints which could potentially allow them to earn more economic rents through exploitation of their market position. The Competition Commission is concerned that the existing regulatory regime has not been able fully to address this issue.
4.55. The Competition Commission’s Market Investigation has highlighted that there are disagreements between stakeholders about the extent to which there has been under-investment in capacity at UK airports and how best to ensure that appropriate and timely investment to serve passengers’ needs occurs in the future. The Competition Commission considers that there has been significant under-investment in new capacity at BAA’s airports in the South East of England, and that this has arisen at least in part from BAA’s market power. The CAA considers that the evidence is much less strong that there has been under-investment at BAA’s airports, and argues that the existing scarcity of capacity is primarily a natural consequence of how pricing and investment occur in a sector such as airports with relatively lumpy assets, rather than any artificial scarcity. We consider that:

- The ATWP recognised that there was a lack of airport capacity in the South East. Therefore, we concur with the Competition Commission that investment has been insufficient historically, although this is based on the DfT’s analysis that socially desirable outcomes have not been met. The Competition Commission’s reviews of the three airports have identified concerns that quality of service has not met users’ needs, hence adverse public interest findings.

- The Government considers that a part of the cause of a lack of investment was the previous planning system, which was one of the reasons for the introduction of the Planning Bill, which has recently received Royal Assent.

- From the analysis for the Stansted airport designation decision we recognise the potentially distorting features of RAB-based regulation (including the incentive to invest too early and on too large a scale, because of the potential to earn a regulated return on any investment included in the RAB, and the lack of focus on users needs in the process of convincing the regulator of the need to include investment in the RAB), but have noted the Competition Commission’s view that RAB-based regulation should be retained for Stansted airport. Furthermore, while recognising the concerns about the potential distortions introduced by RAB-based regulation, this does not appear to have led to over-investment compared to socially optimal outcomes in terms of capacity.

- The DfT’s latest passenger demand forecasts suggest that there is significant unmet demand that might provide the basis for commercial cases to invest in additional capacity.  

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43 RAB based regulation involves the setting of a Regulated Asset Base (RAB) by the regulator that is intended to reflect the value of the assets within the scope of the regulated business on which a return is earned. The RAB changes to reflect additional capex, depreciation and disposals.


The need for Government or regulatory intervention to address the existence of substantial market power or dominance

- If the divestment proposals in the Competition Commission’s Provisional Remedies are implemented there will be more potential for competition than currently. This is likely to lead to more innovation (such as less lumpy investments) than currently, but the extent of that is hard to forecast. As discussed above, the Competition Commission is concerned that even after divestment there may not be sufficient competitive pressures on the three main London airports to remove the need for ex ante regulation, until there has been a significant increase in capacity.

4.56. Overall we consider that there is a strong possibility that the divestment proposals from the Competition Commission will help to promote a more appropriate and timely level of investment than has occurred to date. Over time this greater competition should reduce any negative impact on investment levels that has arisen from the presence of substantial market power or dominance. However, as discussed in the next chapter there may still be differences between this level of investment and the socially optimal level. As discussed in chapters 6 to 9 it will be for the CAA to determine how best to regulate to address substantial market power or dominance with regard to investment, and it will be particularly important for the CAA to ensure that regulation does not hinder the bringing forward of commercially viable investments where the airport operator is prepared to take the commercial risk.

Conclusions on the need to intervene to address market power

4.57. We consider that at least for the foreseeable future there is likely to be an issue of substantial market power or dominance at Heathrow airport that necessitates regulatory intervention. The position over the longer term at Gatwick and Stansted airports is less clear and will depend on a range of factors that will affect the degree of competitive pressure that the airports face. It is too soon to judge whether the divestment proposals of the Competition Commission if implemented, will be sufficient to promote a level of competition at these airports that adequately protects passengers’ interests. For most regional airports it appears likely that for the foreseeable future competition will be sufficient to protect passengers' interests. These airports will remain subject to general competition law provisions, which the CAA will have concurrent power to implement in the airports sector with the OFT (see chapter 7). Airports with more than 5 million passengers per year will also be subject to the provisions of the Airport Charging Directive.
4.58. Where there is substantial market power or dominance it will be important that the regulator acts effectively to protect passengers’ interests, with regard to price, quality and investment. Airlines are likely to have an important role to play in informing the nature of interventions in such cases, but direct evidence of passengers’ views will also be important. Sections 6 to 8 discuss the proposed framework within which the CAA will develop proposals to address substantial market power and dominance.

4.59. At this stage we do not consider there is compelling evidence for specific policy interventions that would involve gathering performance information about all UK airports, but would welcome views on the potential costs and benefits of such an approach. We are proposing that the CAA has a power to intervene at airports to improve co-ordination between the different parties operating at the airport to improve passengers’ end-to-end journey experience. However, it will be for the CAA to judge when and where to use this power taking account of the potential benefits and costs of any intervention, including the possibility of unintended consequences. We would also encourage the CAA when regulating service quality at airports with substantial market power or dominance to consider how these can best be undertaken to create a culture where the airport works with all relevant parties to deliver a good overall experience for passengers.

4.60. Chapters 6 to 8 consider the most appropriate forms of intervention to address the rationales considered above. In developing these proposed forms of intervention we have been particularly mindful of the need to ensure that they are proportionate to the concerns identified and do not have any significant unintended consequences. Given the rapidly changing nature of the aviation sector we have sought to develop proposals that give the CAA flexibility to tailor regulation to best meet the particular circumstances at each airport in the future, with suitable checks and balances on the exercise of these more flexible powers. We consider that passengers’ interests will be best served by tailored, flexible and proportionate regulation.
5. The need for Government or regulatory intervention to address the presence of externalities

Introduction

5.1. In this chapter we consider the strength of the potential rationale for Government or regulatory intervention as a result of the presence of externalities that affect the UK aviation sector.

5.2. In the remainder of this chapter we:

- Summarise the DfT’s initial views on the rationale for intervention with regard to the presence of externalities, including those related to productivity, economic growth and environmental impacts.\(^{46}\)

- Consider the extent to which externalities, including those related to productivity and the environment, provide a rationale for intervention.

- Summarise the current responsibilities of the CAA in relation to the environment and outline a number of recent developments which will see its role change going forward.

- Set out the key conclusions of the Review regarding the rationale for intervention as a result of the presence of externalities in the UK aviation sector, with chapters 6 to 10 explaining the interventions proposed.

- Draw together the conclusions of this chapter and chapter 4 to identify the key features of the proposed new regulatory regime that are then set out in chapters 6 to 10.

Initial conclusions from the DfT’s September 2008 submission to the Competition Commission

5.3. Whilst protecting passengers from a potential abuse of substantial market power, or dominance, provides a strong rationale for some form of ex-ante regulation within the airports sector, there is also a need to consider the broader impacts on society that can be attributed to the sector. DfT’s September 2008 submission to the Competition Commission (CC) explained that the presence of positive and negative externalities from airport development may provide a further rationale for regulatory or other policy intervention in the sector.  

5.4. Externalities arise wherever an individual or firm does not bear the full costs or benefits arising from their actions. In the case of airport development, positive externalities may arise through impacts on UK economic growth and productivity and negative externalities from adverse environmental impacts, such as global climate change impacts and local air quality and noise degradation. If markets are left to operate freely, the presence of significant externalities may lead to inefficient quantities of a good or service being consumed compared to the socially desirable outcome. The presence of negative externalities from airport development may lead to an over supply of airport services. In contrast, the presence of positive externalities may lead to an under supply.

5.5. In some cases, the problem of externalities can be resolved through the allocation of property rights leading to the creation of a market, e.g. allowances giving a right to emit a certain amount of carbon under EU ETS. Property rights allocation is not practical in all cases, such as the right to clean air, and in these cases regulation may be the best approach to ensure that the participants in a market take account of the full costs and benefits that they generate.

5.6. We explain that while a lot of work had been undertaken in recent years to better understand the environmental impacts of aviation and airport development, less had been done to understand the materiality of positive externalities associated with economic growth and productivity. We noted that these wider impacts on society needed to be appropriately considered and accounted for, in the context of other relevant EU and UK legislation, when designing any reforms to the regulatory framework for airports. We recognise that such considerations are a wider public policy concern outside the remit of the Competition Commission’s on-going Market Investigation.

5.7. In terms of the wider environmental impacts on society, the submission highlighted that the DfT continues to undertake a substantial work programme to attach monetary values to the environmental impacts of aviation. While such estimates are inevitably uncertain, we believe that work to date shows that there are material negative environmental externalities associated with aviation. These are taken into account in the wider

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Government policy framework for aviation; the submission went on to explain the range of existing (and pending) environmental regulations and policies that Government has put in place which seek to address the environmental impacts of airport development. We discuss these issues in more depth later in this chapter.

5.8. We also noted that the evidence base for assessing the external productivity effects of airport development through impacts on trade and Foreign Direct Investment (FDI) was much less developed than evidence on assessing the adverse environmental impacts. The submission explained that DfT believes there to be potentially material benefits for economic growth and productivity which may not be fully captured in the private costs and benefits of transport projects. Indeed, the Eddington Study (2005) recommended that DfT should seek to improve its evidence base for assessing the wider impacts of transport on productivity and economic growth, including those impacts through trade and FDI. To try and better understand the significance of these impacts, the DfT commissioned NERA to help to quantify the impact of improvements to international transport links on UK growth and productivity.

5.9. As noted in the previous chapter, the DfT explained that different types of regulation or policy interventions may be more likely to be appropriate for different types of rationales, although each case must be evaluated on its own merits. Typically, a wider range of policy interventions have been considered to address externalities than concerns about the presence of substantial market power or dominance. These include: guidance to the regulator; measures to directly address environmental impacts (including limits on noise and air quality); EU ETS, and Government expenditure or taxation. We recognise that generally the Government is best placed to take the lead in developing such policies, rather than the economic regulator, but we consider, consistent with approaches in other sectors, such as the energy sector, that the regulator can play a positive role within an appropriate framework to help achieve some of the environmental objectives of the Government.

5.10. The DfT has considered a range of information to inform our consideration of the rationale for intervention given the presence of externalities. The additional information and analysis is briefly discussed below and relates to responses to the DfT’s September 2008 submission to the Competition Commission and the work to date on NERA’s study into the impacts of improvements to international transport links on UK growth and productivity. Some of the new evidence and analysis discussed in the previous chapter regarding the presence of substantial market power or dominance is also relevant to the consideration of externalities, including with regard to investment in capacity expansion.
Reforming the framework for the economic regulation of UK airports

Responses to the DfT’s September 2008 submission to the Competition Commission

5.11. Stakeholder responses provided useful input to the Department on the appropriate design of proposals for regulatory reform. The full summary of responses to the DfT’s September Submission to the CC is published alongside this consultation. With regard to the rationale for intervention to address the presence of externalities the main points raised were:

- There was little support from stakeholders for giving the regulator a primary duty in relation to the environment, although there was some support for a requirement to have regard to such matters. In particular, the CAA noted that in other sectors, environmental issues have typically been included in the statutory duties of the regulator, but have not featured in the primary objective. The CAA expressed the view that this structure avoids the risk that regulators are given conflicting objectives or are required to take complex policy decisions that are best left to elected officials.

- BA expressed a similar view. BA believed that the Government should continue to be responsible for environmental policy, given its political nature. BA also believed that the Government should have the ability to give guidance to the CAA on environmental policies and measures to ensure that these are taken into account.

- Manchester Airports Group (MAG) did not support imposing environmental duties in relation to economic regulation on the CAA. MAG recognised concern for the environment and climate change as a major issue facing aviation. However, MAG believed that aviation is not a special case requiring additional environmental controls over and above the regulatory regime that applies to other industries.

- The Northern Way was supportive of the internalisation of environmental externalities. The Northern Way noted that mitigation of environmental impacts needed to be an integral part of any investment proposal and further noted that regulation should encourage this but it should not seek to duplicate what is best dealt with through the planning system.

External impacts of aviation from airport development

5.12. The presence of externalities can be just as important as the presence of substantial market power or dominance in leading to sub-optimal outcomes from a societal perspective. An independent regulator may not always be best placed to address these issues where more political judgements are required. Economic regulation may also not be the most appropriate way to address externalities, partly because Government is better placed to take some decisions but also because economic regulation focuses on airports with substantial market power or dominance, whereas externalities may be present at a broader range of airports. However, there are examples in other
The need for Government or regulatory intervention to address the presence of externalities sectors, including energy, of the regulator playing a positive role in helping to achieve some of the Government’s environmental objectives. In the case of aviation there are likely to be substantial externalities that could affect positively and negatively the appropriate quantity and quality of services and capacity that should be provided.

5.13. Table 5.1 below illustrates the current differences between the Government’s social business case for investments and the approach that might be expected to be followed for a commercial business case.

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<th>Table 5.1 – Differences in coverage of social and commercial CBAs</th>
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<td>Benefits to Government 48</td>
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<td><strong>Existing users</strong></td>
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<td>Benefits to operator</td>
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<td><strong>Wider economic impacts 50</strong></td>
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<td><strong>Environmental impacts</strong></td>
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<td>Noise disbenefits</td>
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<td>Local air quality disbenefits</td>
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<td>Carbon disbenefits</td>
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48 ‘Benefits to Government’ refers to additional taxation raised through additional airport activity.

49 The losses to the operator and to airlines on existing users are exactly offset by the gain to existing passengers. As this is just a transfer, these gains and losses are not estimated separately in the social CBA.

50 Wider economic impacts include impacts on productivity and foreign direct investment, as discussed elsewhere in this document.

51 Commercial CBA will price carbon through the operation of the EU ETS scheme, for those flights subject to it. In addition, the biggest airports are covered by the main ETS scheme and a broader set of other airports will be covered by the Carbon Reduction Commitment from 2010 which will require them to purchase carbon allowances to cover their own emissions. The Government has also undertaken an assessment of whether aviation is meeting its environmental costs, which included the impact of APD on the overall costs faced by the industry (Ref: Emissions Cost Assessment, July 2008, DfT).
5.14. This highlights the more limited scope of commercial appraisal. Of the thirteen categories of cost and benefit considered in the social case only five are relevant commercially – the infrastructure costs, profits from additional passengers and the reduction in profits from existing passengers due to the removal of a capacity constraint. The discount rate used for a social business case is also likely to be lower than that used for a commercial business case, due to a different view about societal and private time preferences.

5.15. We have considered below the two main types of externalities that may be relevant for aviation – productivity and growth externalities and environmental impacts.

**Productivity and growth externalities**

5.16. The Eddington report identified the existence of wider and potentially positive externalities, where good quality airport links encourage businesses to locate in the UK and facilitate greater trade between the UK and other countries. Inevitably these externalities are difficult to quantify, but even a relatively small positive impact on economic growth in percentage terms, would be a large monetary value.

5.17. A change in travel cost and service quality for journeys passing through UK airports may affect the level and pattern of UK trade and FDI, and may therefore impact on UK productivity and UK well-being. FDI and trade could be affected by changes in travel time, money costs, and service quality of journeys through an airport. The key issue in terms of increasing the ‘attractiveness’ of travel through the UK, is that the overall transport ‘experience’ is improved whether through service quality, travel time or cost.

5.18. Investment in transport infrastructure impacts on the costs and service quality of journeys and are therefore likely to impact upon flows of trade and FDI. Changes in trade and FDI flows are likely to have some externality impacts that are additional to the impacts considered in standard airport cost benefit assessments. For example, changes in trade and FDI flows may impact on the wider productivity of the economy. These wider economic impacts are of interest because they do not directly affect commercial airports as there is no direct link between the wider economic impacts and commercial profits. This indicates there could be a difference in ‘the best policy’ for a commercial organisation when compared against what is best for the wider economy and society.

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52 This analysis assumes that there is a runway capacity constraint in the base case.
5.19. As discussed earlier in this section, NERA have been commissioned to gather evidence about productivity and growth externalities and to develop a ‘pragmatic’ methodology for assessing these ‘wider impacts’ of transport investment in an international context. Focussing on impacts not already included in a standard airport cost benefit assessment, NERA are attempting to develop an approach which quantifies the following wider economic impacts:

- Increased productivity associated with any additional exporting that is expected as a result of a transport intervention.
- Impacts on employment in areas of structural unemployment that are estimated to result from the transport intervention. Impacts on employment may result from changes in the amount of expenditure, such as from changes in tourism levels, in the areas concerned.

5.20. NERA’s research is not yet complete, although their initial work has confirmed the DfT’s understanding that these wider economic impacts are inherently difficult to measure. Given these uncertainties, at this stage of the Review, we do not consider the presence of wider economic impacts provides a sufficiently robust rationale for regulatory intervention. We await the final findings of the NERA research with interest and will draw upon the results in the course of developing the final proposals for Legislative change that will be published later this year.

5.21. In addition to these wider economic impacts associated with trade and FDI it remains important to consider other wider benefits, such as delay reduction and reliability that the DfT already takes into account in its social business case assessment of new airport investments. DfT’s September 2008 submission to the Competition Commission in response to its Provisional Findings also noted that there are a range of studies that suggest there is evidence of wider economic impacts from aviation.

**Environmental externalities**

5.22. The Review’s environmental objective for airport development is consistent with the 2003 Air Transport White Paper (ATWP) which recognised that environmental impacts such as air pollution and noise can arise from the operation and development of airports and set out a clear policy framework for how these challenges should be addressed. The Government’s objective is to strike a fair balance between the local and national benefits that can be gained from airport operations and the local environmental costs that might be imposed on the people who live nearest to them.

5.23. The objective is also consistent with the Government’s proposed approach to long-term transport planning in the document Towards a Sustainable Transport System.” This document was published in 2007 in response to the Eddington Study and the Stern Review and set clear goals which take full account of transport’s wider impact on climate change, health, quality of life and the natural environment.

[^53]: http://www.dft.gov.uk/about/strategy/transportstrategy/pdfsustaintranssystem.pdf
5.24. Aviation and airport development generates a number of adverse environmental impacts. These arise from aviation, the operation of airports (in terms of ground handling practices as well as the terminal buildings) and from surface transport links to the airport. Climate change impacts (public bads) are perhaps one of the most important. In addition, there are a number of local environmental externalities associated with airport development, including those of noise and air quality which have an adverse impact on populations surrounding an airport:

- Local noise;
- Local air quality impacts (e.g. NO$_x$ and PM10);
- Climate change effects (e.g. CO$_2$ impacts);
- Other environmental impacts: habitat, biodiversity etc.

**Addressing the environmental impacts of aviation from airport development**

5.25. As set out in the Review’s September submission to the Competition Commission, there are a wide range of existing (and pending) statutory provisions that directly or indirectly address the environmental impacts of aviation on airport development. These provisions cover climate change effects, local air quality and noise, as well as other environmental requirements, such as the need to demonstrate compliance, for example, on the disposition of hazardous/damaging chemicals (e.g. fire-fighting foams and anti or de-icing chemicals) and the management of waste and surface water."

5.26. It is important to note that in many instances these provisions are applicable, not just to airport development, but across all sectors of the economy. This approach to environmental regulation reflects the fact that many environmental impacts from airports are no different to other large industrial installations.

**Climate change effects**

5.27. The contribution of the aviation sector to climate change occurs largely through the production of CO$_2$. Other impacts include the production of nitrogen oxides and water vapours leading to the formation of contrails, although these are more difficult to measure. In addition to emissions from aircraft en-route to their destination, additional emissions may arise due to operational inefficiencies such as keeping aircraft in “stacks” prior to landing for longer than is operationally efficient – this is especially the case in congested airspace or at airports which have fully utilised runway capacity. Aircraft also contribute to climate change emissions while at airports via ground handling practices such as taxing, the operation of the Auxiliary Power Unit (APU) and terminal approach. Carbon emissions from airport buildings and surface access to airports further increase the climate change effects associated with airport development.

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54 Annex 4 provides a summary of existing environmental legislation which airport operators must comply with.
5.28. Government strategy to address the climate change impacts of aviation involves the inclusion of aviation in the ETS, the setting of a target to bring aviation CO\textsubscript{2} emissions in 2050 back to 2005 levels, the encouragement of, and support for, technological development and the promotion of improved air traffic management. Annex 3 provides further details on this policy framework. The overarching objective of this policy framework is to reduce net carbon emissions to socially desirable levels at least cost.

5.29. Of particular relevance to airport development is the inclusion of domestic and international aviation in the EU ETS from 2012, and the inclusion of domestic aviation emissions in National Carbon Budget legislated for in the Climate Change Act. Carbon emissions from the operation of airport buildings are to be captured under a range of different schemes dependent on energy use. These include ETS for airports which qualify (Heathrow, Gatwick and Stansted airports are within the current phase of ETS) and for those which do not, the proposed implementation of Carbon Reduction Commitments (CRCs) from 2010 will mean that all but the smallest airports will be required annually to purchase carbon allowances to cover their carbon emissions." It is intended that from 2013 the available allowances will be capped in line with meeting the trajectory of the agreed National Carbon Budget for the period.

5.30. Participation in these schemes should ensure that the climate change costs of aviation are appropriately priced into airport investment decisions, either directly through the additional costs from purchasing permits reflected in higher airport charges or indirectly through the impact of higher air fares."
Both may lower the demand for air travel and reduce the benefits of airport expansion which impacts on both the scale, but perhaps more importantly the timing of airport expansion. It is important for airport operators to bring forward commercial developments using airport demand forecasts that reflect these additional costs (such as the demand forecasts generated by DfT’s UK air passenger and CO\textsubscript{2} forecasting framework)," although we note that it is not in the interests of airport operators to risk assets being under-utilised for longer than is commercially necessary; there are strong incentives for airport operators to make best use of robust passenger forecasts that reflect these additional costs.

5.31. It is also important to note that sustainable development sits at the heart of the new planning regime introduced by the Planning Act 2008. When preparing national policy statements, the Government is required to do so with the objective of contributing to the achievement of sustainable development, and in particular to have regard to the desirability of mitigating and adapting to climate change. National policy statements will provide the basis for the independent Infrastructure Planning Commission’s decision making on nationally significant infrastructure projects.

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55 Energy usage from commercial activities within the airport operated by a parent company whose total annual energy usage is below 6000 MWh will not be required to take part in the scheme.
56 We refer here to the costs associated with reducing carbon emissions to socially desirable levels at least cost rather than reflecting the total costs of climate change.
57 Details of the latest forecast: http://www.dft.gov.uk/pgr/aviation/atf/co2forecasts09/
Local noise from airport operations

5.32. Noise from aviation sources is an important issue for many residents living near airports. The ATWP set out a clear policy as to how these challenges should be addressed. In particular the ATWP had an aim of limiting and, where possible, reducing the number of people in the UK significantly affected by aircraft noise. It is important to note, however, that currently there are no legal limits on maximum noise exposure levels to individuals at specific locations (as there are with regard to local air quality), although as we discuss later in this chapter Government’s support for a third runway at Heathrow airport includes limits on the noise impact from the airport operations being given legal force, and there are provisions for limits to be introduced on local noise exposure levels.

5.33. In terms of noise management, the Government has, through the European Directive on Noise Related Operating Restrictions (2002/30/EC) adopted the ‘balanced approach’ as recommended by the International Civil Aviation Organisation (ICAO). This has been incorporated into UK legislation by the Aerodromes (Noise Restrictions) (Rules and Procedures) regulations 2003. Under the Directive, any operating restrictions at the largest airports (i.e. with 50,000 and above annual movements) have to take into account costs and benefits of measures, be non-discriminatory on grounds of nationality or identity of air carrier or aircraft manufacturer and be no more restrictive than necessary in order to achieve the environmental objectives for a specific airport.

5.34. In addition to management practices, the Civil Aviation Act 1982 provides the Secretary of State for Transport with powers to impose regulations governing aircraft noise at airports designated for noise control purposes. So far, these powers have been used in respect of the currently noise designated Heathrow, Gatwick and Stansted airports. At other airports the policy of successive Governments has been that local environmental issues are best resolved at the local level wherever possible. This recognises that airports vary enormously in their size and type of operations and in their local circumstances such that a ‘one size fits all’ approach to noise control measures would be inappropriate.

5.35. To assist airports in managing aircraft noise, the Civil Aviation Act 2006, among other things, strengthened and clarified powers to control aircraft noise and emissions, in line with commitments in the ATWP. In particular, airport operators were given statutory powers to introduce noise control schemes and fine aircraft that breach noise controls. The Act also provided powers for all licensed airports to introduce charges that reflect the pollution generated by each aircraft type. Prior to this some airports e.g. Heathrow operated a landing charges system in relation to the noise emitted by the aircraft as part of their conditions of use.
5.36. Part of Directive 2002/49/EC on the assessment and management of environmental noise requires member states to carry out noise mapping and action planning at major airports and those airports that affect agglomerations (urban areas). The regulations have been separately transposed in England and the three devolved administrations. Action plans have to be designed to manage noise issues and effects, including noise reduction if necessary. These plans will be formally adopted in England by the Secretary of State for Environment, Food and Rural Affairs, and have to be reviewed, and revised if necessary at least every five years.

Local air quality

5.37. In contrast to noise, local air quality is regulated by EU and national legislation which sets fixed limits that need to be adhered to in relation to a range of emissions (including benzene, 1,3-butadiene, carbon monoxide, lead, nitrogen oxide, oxides of nitrogen, PM10 and sulphur dioxide). The national legislation states that the Secretary of State shall take measures to ensure that concentrations do not exceed the specified limit values.

5.38. Air quality limits are different from other environmental impacts in that they are defined as fixed concentration levels. The key metric for consideration is overall air quality in specific locations irrespective of whether these emissions are from surface transport, industry or the airport itself. Local Authorities have responsibilities in terms of measuring local air quality and where pollutants exceed the set standards the area in question must be designated an Air Quality Management Area (AQMA) with an action plan formulated by the Local Authority as to how their powers should be exercised to achieve the necessary standards.

5.39. As with noise management, the Civil Aviation Act 2006 introduced statutory powers enabling airports to levy airport charges in line with local emissions. BAA has used these powers at a number of its airports, including Heathrow and Gatwick airports, to flex landing charges in line with NO\textsubscript{x} emissions (per kg rate). The Secretary of State also has powers to direct airports to levy such charges.

5.40. In terms of airport development, airport operators are required to take local air quality impacts into account at the planning stage of the development process via an environmental impact assessment, and are required to determine the extent of any exceedances predicted in relation to local air quality targets.
The CAA and the environment

5.41. When the Civil Aviation Act 1982 established the CAA, the environment was not set as a priority for the organisation as a whole. However, the CAA does currently have a number of responsibilities in relation to the environment. These are derived from international standards, European legislation and domestic legislation, directions and guidance. The responsibilities apply to a wide range of functions carried out by the CAA. The CAA's corporate plan includes an objective to encourage civil aviation to reduce, control and mitigate the impact of the aviation community on the environment. The CAA supports the principle that aviation should meet its full environmental costs, ensuring that growth in aviation only occurs where these costs are outweighed by the economic and social benefits.

5.42. There are two main pieces of primary legislation that refer to the CAA's environmental duties. Under the Transport Act 2000, when exercising its air navigation functions, the CAA must balance various factors set out in the Act. One of these is to take account of any guidance on environmental objectives given by the Secretary of State.

5.43. The second reference is in the Civil Aviation Act 1982. Section 5 requires the CAA to consider environmental factors when licensing an aerodrome that the Secretary of State has specified in an order. In such circumstances, the CAA would be required to minimise so far as reasonably practicable any adverse effects on the environment and any disturbance to the public. The Secretary of State has not used these powers.

5.44. The CAA also undertakes other environmental activities. For example, its Environmental Research and Consultancy Department gives authoritative scientific advice to the Government on noise and represents the UK in technical forums nationally and internationally. In safety regulation, there are aircraft engine experts who advise Government on emissions performance for the purpose of international negotiations. Environmental design issues in respect of aviation have now largely been transferred to the European Aviation Safety Agency. In economic regulation, the CAA can take into account environmental expenditure as part of the airports price control process. It also provides advice on economic instruments related to climate change.

5.45. As mentioned above, the EU ETS is expected to include aviation carbon dioxide emissions from flights to, from and within the European Union from 2012. Introducing market mechanisms in this way is a key aspect of European and UK Government policy on transport and the environment and the CAA has been closely involved in the development of this policy and will have a role in support of the Environment Agency regulating aircraft operators in the scheme.
Pilling Recommendations

5.46. In his Strategic Review of the CAA, Sir Joseph Pilling made the point that the environment is an area of increasing importance in today’s society and in the aviation world. He recognised that the CAA already takes the environment into account in a number of different areas of its work, and made the recommendation that this should be reflected in legislation by means of a general statutory duty in relation to the environment. He also made the point that there are a broad range of views on how to respond to the challenge of aviation and the environment, including strong opinions at either end of the spectrum. He advised that CAA should not go beyond its role of independent regulator to become a campaign body on the environment.

5.47. In addition, Pilling advised that the CAA should not be given a general duty in statute without a clear policy framework from Government. The Secretary of State should be responsible for providing a framework which offers guidance to the CAA on how to strike the balance on the inevitably difficult issues where there is a trade off to be made between the environment and other considerations. The framework should make clear the boundary between the roles of the CAA, the Government and other stakeholders. It must give enough of a steer to allow the CAA to make a decision that is aligned with Government policy. But at the same time the framework must not be overly prescriptive.

5.48. The Department is working with the CAA to implement these recommendations over the coming months, and in particular considering the extent to which a general environmental duty relates to each of its regulatory functions.

Heathrow, the environment, and the role of the CAA

5.49. On 15 January 2009 the Secretary of State announced support for plans for a third runway at Heathrow airport, conditional on any development meeting strict local environmental conditions. The Secretary of State made a commitment that additional flights will only be allowed when the CAA is satisfied that:

- the noise and air quality conditions have already been met. The air quality limit is already statutory. The noise limits will be given legal force.
- any additional capacity will not compromise the legal air quality and noise limits.

5.50. These commitments are made in the context of the CAA’s proposed new statutory environmental duty as recommended by the Pilling Review, to ensure that the CAA acts in the interests of the environment in addition to its existing obligations and duties, and that it follows guidance from the Secretaries of State for Transport, Environment, and Energy and Climate Change.
Moreover, in the event that air quality or noise limits were breached, the independent regulators will have a legal duty and the necessary powers to take action – or require others to take the action – needed to come back into compliance. In the case of noise this would be for the CAA. In the case of air quality, where emissions from roads and rail around Heathrow airport also need to be considered, the Environment Agency will act as the enforcement body with appropriate guidance from Ministers.

These environmental commitments are complementary to any proposals from this Review. They provide an important part of the wider policy context, alongside the Government’s strategy to address the climate change impact of aviation through the inclusion of aviation in the EU ETS, the setting of a target to bring the UK’s aviation CO\(_2\) emissions in 2050 back to 2005 levels, the encouragement of and support for technological development and the promotion of improved air traffic management.

Work is underway to develop detailed plans to give force to the assurances related to the expansion of Heathrow airport, which have been announced. This includes, for example, clarifying the activities needed, the precise role of the different organisations, and the identification of any necessary powers and duties. Although they do not apply directly to the economic regulation of airports, the Government will consult in due course on these issues. We recognise that many taking an interest in this current consultation will also want to be involved in consultation on these other matters. We also recognise the importance of setting out a coherent overall approach on the environment within which environmental aspects of economic regulation will sit.

Conclusions on the need for additional environmental provisions to address the environmental impacts of airport development

It is clear that the development and operation of airports can have significant environmental impacts and the Government has put in place a framework of environmental regulation to address these. Some impacts are addressed by general environmental regulation, as it applies across the economy, whereas others are addressed by aviation-specific provisions. Where these are effective there is little prima facie case for applying additional environmental regulation to airports. Indeed, to do so may prevent socially beneficial airport expansion from taking place. Where existing provisions are deemed ineffective – potentially leading to an over-provision of airport capacity – then Government is probably best placed to consider how best to take these impacts into account. The Secretary of State’s support for plans for a third runway at Heathrow airport, conditional on any development meeting strict local environmental conditions, provides a good example of such action.

For example, if EU ETS covers all aviation related CO\(_2\) emissions then further regulation would attach too high a price to the externality, thereby suppressing economic activity below a level deemed necessary to reduce CO\(_2\) emissions to a socially desirable level in order to address climate change.
5.55. Airport operators and economic regulation must work within the context of this environmental policy framework. However, it is also clear that regulatory decisions taken within this framework can have different environmental consequences. The Government would want to be confident that the economic regulator takes account of the Government’s environmental objectives. We discuss in the next section how best to address this issue, but it is likely to be through the regulator taking account of or having regard to the environmental policy framework rather than setting the framework.

Conclusions on the need to intervene to address the presence of externalities

5.56. We consider that it is important that major airport investment decisions take full account of the externalities that are present to ensure that investment decisions represent socially desirable outcomes. However, we consider that it should primarily be for the Government and not an independent economic regulator to reach a view on the magnitude of such externalities and how they impact on investments that would be permitted. The detailed proposals for the statutory objectives to apply to the CAA are set out in the next section. We are proposing that economic regulation has a duty to assist in the delivery of airport infrastructure consistent with the National Policy Statement (NPS) on Airports, which will be developed by the Government under the Planning Act 2008. In this way the economic regulator will take account of the Government’s views of the national need for airport infrastructure based on economic, social and environmental considerations. It will remain for airport operators to decide whether to bring forward particular projects, but we would expect that the new regulatory framework will facilitate investments by airport operators that are consistent with the Government’s policy, and where the airport operator is content to bear the commercial risk of the project.

Implications of our conclusions on the need for intervention for the design of an effective regulatory framework for airports

5.57. Reflecting our conclusions set out above and the conclusions in chapter 4 on the need for intervention, we aim to develop a framework for the economic regulation of airports that:

- Puts the interests of consumers first.
- Wherever possible, relies on competition between airports and the application of competition law to achieve this objective.
- Focuses the regulator on protecting consumers from an abuse of substantial market power which may result in a poorer outcome for consumers than would be the case in a more competitive market. The aim of any intervention should be to replicate, as far as possible, outcomes that might be expected in a well-functioning competitive market.

- Recognises that the development of airports has wider environmental and productivity impacts which may not always be taken into account by airport operators, and which, in the case of large capacity expansion projects, may be significant.

- Is sufficiently flexible to be adaptable to a broad range of changing market circumstances regarding the ownership structure of airports and the balance of supply and demand for airport capacity over time.

5.58. The proposed framework set out in the following chapters seeks to empower the economic regulator, with appropriate checks and balances, to determine the most appropriate regulatory arrangements to further the interests of consumers of passenger and freight services and adapt as the aviation sector changes. The proposed framework – comprised of statutory duties, governance arrangements, regulatory instruments and appeals processes – should be viewed as a package of proposals developed with reference to the conclusions on the need to intervene. Whilst changes to any one element of this package of proposals may be helpful, a fully effective framework for the economic regulation of airports depends on the appropriate balance between all these elements.
6. Statutory remit for the economic regulation of airports

Introduction

6.1. 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. In this chapter we set out our proposals for the statutory remit for the economic regulation of airports, having regard to our conclusions in the previous sections on the need for regulatory intervention to meet the Secretary of State’s objectives for the Review.

6.2. This chapter sets out:

- Important context to the development of proposals for reforming the statutory remit of the economic regulator;
- Implications of the proposed reforms for economic regulation in the Devolved Administrations;
- Proposed reforms to the statutory remit of the economic regulator; and
- A summary of the changes that are taking place to the governance arrangements of the CAA.

Context for developing proposals for the statutory remit of the economic regulator

6.3. Under current arrangements, the CAA has a discrete set of duties for the purposes of economic regulation which were set down 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:

i. to further the reasonable interest of users of airports within the UK;
ii. to promote the efficient, economic and profitable operation of such airports;
iii. to encourage investment in new facilities at airports in time to satisfy anticipated demands by users of such airports; and
iv. to impose the minimum restrictions that are consistent with performance by the CAA of its functions.
In addition, there is a requirement for the CAA to take account of international obligations. Further details of the current economic regulatory framework are provided in Annex 3.

6.4. 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. The governance arrangements for the CAA will also play a major role in the operation of the regime in practice. We note the emphasis placed on this issue by the Expert Panel in their advice to the Secretary of State. Issues associated with governance of the CAA were considered in the Pilling Report and the Government has accepted the recommendations concerning the future internal structure of the CAA. We set out the steps taken so far to implement these changes later in this chapter.

6.5. The CAA also has a set of general statutory duties which do not apply to economic regulation. These were set down in statute by the Civil Aviation Act 1982 and are currently being reviewed by the DfT following the recommendations of the Pilling Report. In particular, the Government has already accepted that there should be a general statutory duty for the CAA in relation to the environment. We aim to consult on proposals to reform the CAA's general duties later in the year. We see some benefits in ensuring stronger coherence and alignment between these general duties and its functional duties, including those for economic regulation, particularly given the proposed reforms to internal governance (which we set out later in this chapter). However, we also need to ensure that functional duties are tailored to their specific regulatory purpose. In this regard the proposed primary focus of economic regulation – as set out below – will be on promoting the interests of consumers, with environmental issues considered as part of its further duties, while the general duties of the CAA are likely to have more regard to the environment and safety issues. This is consistent with the principles Better Regulation to maintain the focus of economic regulation, however as these general duties are developed over the next few months we will need to reflect further on how our proposals for economic regulation relate to the proposed general duties for the CAA.

6.6. It is important to note that the drafting of the duties below sets out the policy intent of the proposed statutory remit, building on the advice of the Expert Panel. We welcome views on both the policy intent and the precise wording of the duties, but note 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. However, even before we get to that point we will need to further reflect on the responses to this consultation.
Economic regulation of airports in the Devolved Administrations

6.7. The overarching framework for the economic regulation of airports in Scotland and Wales is a reserved matter with DfT retaining responsibility for policy development. The separate legislation that provides a framework for airport regulation in Northern Ireland currently closely follows that for other parts of the UK and is overseen by the CAA. The UK Government’s proposed reforms will be taken forward in close consultation with the Devolved Administrations, with particular regard to where the proposed reforms to economic regulation overlap with other devolved regulatory functions, such as planning and the environment, and recognising that economic regulation may serve to address different issues in the Devolved Administrations from those in England and at the London airports in particular.

Proposed statutory remit of the economic regulator

6.8. We propose to replace the four duties of the economic regulator 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”

supplemented by further duties of the following general kind:

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.

We note that some regulatory functions in relation to airports in Scotland and Wales are devolved matters. For example, the Scottish Government is responsible for planning and environmental regulation of airports and airport development in Scotland and the Welsh Assembly is responsible for town and country planning and related environmental impact assessment associated with airport development in Wales. The Scottish Government also has an existing limited power to remove certain airports from economic regulation.

We discuss what we mean by ‘further duties’ in paragraph 6.18.
Reforming the framework for the economic regulation of UK airports

Structure of the economic regulator’s duties

6.9. In forming these proposals we have considered different ways of structuring the duties to provide the economic regulator with a clear statutory remit. In this regard we note that the duties of some economic regulators have been split between primary and further duties, although this approach is not consistent across all the economic regulators. The House of Lords Select Committee on Regulators report on economic regulation (2007) recommended that whilst regulatory statutes should “give a clear steer” on how duties should be prioritised, it also recognised that a requirement on regulators to take account of guidance could achieve a similar outcome. It would therefore appear that there is no standard approach to structuring the statutory remit of an economic regulator, although some form of prioritisation is felt to be beneficial.

6.10. We propose a structure of duties that provides the economic regulator with a clear, single primary duty supplemented by a limited set of specific factors that the regulator should also consider when seeking to achieve its primary duty. The advantage with this approach, compared to the current structure of co-equal duties with no clear hierarchy, is that it will enable the CAA to make clearer decisions, with stakeholders better able to understand why certain decisions have been made.

6.11. Our thinking has been informed by responses to our initial consultation. A number of stakeholders told us that they were unclear how the CAA currently balances its current duties. Indeed some stakeholders have expressed concern that the CAA places undue prominence on specific duties rather than others. For example, the Competition Commission in its provisional findings has raised concerns that the CAA may place undue prominence on its duty to impose minimum restrictions. A primary duty accompanied by further duties should help provide this additional clarity. Indeed, the CAA has indicated that its role and approach would be aided by a single primary duty, supplemented by further duties.

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?

Primary duty

6.12. We believe that the principal objective of economic regulation in the airports sector should be to promote the interests of consumers of air services, i.e. airline passengers and customers of freight services. Promoting these interests should involve considering the role of airports within part of a wider integrated transport system. This primary duty reflects the fact that

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ultimately it is the consumers of air services that are being served by all the parties in the aviation sector and is consistent with recent ICAO thinking (document 9082) regarding the purpose of regulating airport and air navigation services.”

6.13. Where there is effective competition between airports for airlines and passengers, the process of competition can be expected to promote the interests of consumers by providing airports with incentives to provide airport services (in terms of both quantity and quality) that airlines and consumers demand at least cost. If an airport does not provide these services they risk losing airlines and consumers to rival airports (the evidence discussed in chapters 3 and 4 regarding regional airports support this view). Where an airport has substantial market power or dominance, the purpose of economic regulation should be to remedy the absence of competition, with the aim of delivering outcomes that would be expected in a well-functioning competitive market.” The shortcomings at some of the London airports discussed in earlier chapters, and the Competition Commission’s Market Investigation into BAA airports, illustrate the potential consequences of the presence of substantial market power or dominance. The potential power of competition to promote the interests of consumers is why this forms part of the regulator’s primary duty.

6.14. There was broad support from stakeholders responding to our September 2008 submission to the Competition Commission that the primary duty of the regulator should be to promote the interests of passengers. However, there was some discussion about how this could be achieved. The majority of responses felt that the regulator’s duty should be framed in terms of consumers only. This group of stakeholders included the CAA, the Air Transport Users Council (AUC), London First and Manchester Airports Group. While airlines were seen as playing an important role in informing the regulator about passenger interests, there was some concern that the interests of these two groups are not always aligned. For example, while the CAA noted that airlines could provide an important source of information on passengers’ preferences, the CAA noted a number of instances where airlines had acted contrary to the interests of consumers. These included cases where:

- Airlines have been found to have breached European competition law;
- The Office of Fair Trading (OFT) has required modification of the online booking process and the way in which airfares were promoted; and
- The Advertising Standards Agency has brought cases against misleading advertising by airlines.

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62 See http://www.icao.int/icaonet/dcs/9082.html
63 Whilst regulation is unlikely to be a perfect solution to a lack of effective competition, and cannot reasonably be expected to result in outcomes that exactly match those that would be expected in a well-functioning competitive market, the aim of regulation should be broadly to replicate, as far as is reasonably possible, the competitive market outcome.
6.15. The main divergence to this view came from airlines who expressed a preference for having a primary duty referring to users (including consumers and airlines) as a group. The airlines broadly agreed that the interests of passengers were key but they believed that these interests would be aligned with the interests of the airlines. For example, British Airways saw no evidence of any material divergence of interests between airlines and passengers concerning airport matters.

6.16. Given a broadly competitive airlines market, we believe that the interests of airlines and consumers of air services frequently coincide, and that airlines are capable in a good many cases of representing the interests of passengers. There are also a number of areas of airport activity which passengers do not directly observe (but which have a direct impact on their through-airport experience) and where they cannot be expected to express an opinion. Therefore, in our view airlines – as large, well-informed buyers of airport services with specialist information – should have a very important role in the regulation of airports. In return, this places additional responsibilities on airlines to engage constructively with airport operators, the economic regulator and other stakeholders. It will also be important for the economic regulator to consider carefully the weight of evidence on occasions where it considers that airlines’ views do not align with its primary duty towards consumers. In these situations, it will be important for the regulator to be able to justify that an alternative position better represents passengers’ interests.

6.17. While we consider that airlines should play an important role in the regulatory process we do not feel that this would be best achieved by referring directly to airlines in the regulator’s primary duty. To do so would risk blurring the purpose of economic regulation and is also unnecessary. A primary duty to promote the interests of consumers inherently includes the way in which the airport serves airlines and responds to their requirements. An airport which offers inadequate, inefficient and poor quality services to airlines – and does not pay attention to the views of the airline community – would not be properly serving the consumer interest. We therefore believe that providing airlines with additional rights within the regulatory process itself would be a more effective way of ensuring passengers’ views are articulated within the regulatory process than widening the scope of the primary duty to include airlines. Therefore, we propose to:

- Supplement the regulator’s primary duty with a duty on the regulator to provide an appropriate framework for consultation between airport operators and airlines. We discuss this further below.
- Introduce licence conditions obliging the airport operator to provide information to and, to consult with airlines. We discuss this further below.
- We are also consulting on whether airlines should have the ability to appeal the merit of key decisions taken by the regulator. We discuss this further below.
6.18. Alongside these additional rights for airlines we also propose significant reforms to existing institutional arrangements regarding consumer representation in the sector. We discuss our proposals, in the context of reforms to the economic regulation of airports, in chapter 9. We consider that the effect of both these (and other changes) will be to ensure that the views of final consumers are more effectively articulated within the regulatory process.

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?

Further duties

6.19. We propose to supplement the proposed primary duty to promote the interests of consumers with a limited set of specific factors that the regulator should also consider when seeking to achieve its primary duty. We have called these factors further duties to make it clear that they would not override the regulator’s primary duty. We recognise that it can be argued that these further duties may not be necessary given that the primary duty focuses so clearly on the interests of consumers which in turn implies adequately financed companies. However, our current view is that there is merit in clarifying – for all parties involved in the airports sector – the specific factors that we would want the economic regulator to consider when undertaking its regulatory activities to promote the interests of consumers. We will need to think about how to give effect to these further duties following consultation and welcome views on whether these duties are appropriate.

6.20. Reflecting the extensive range of existing environmental regulations that impact on the development of airports and to ensure that economic regulation works consistently within these frameworks, we propose a duty on the regulator to have regard to the effect on the environment and on local communities of activities connected with the provision of airport services. This is not intended to encourage the CAA to duplicate existing environmental provisions rather it is intended to ensure that the development of airports takes place within any set environmental limits. In pursuit of this end, we propose that large airports should be required to publish reports setting out how they plan to meet their environmental obligations and what steps they are taking to engage local communities on the issues that affect them. These would be available to the scrutiny of the CAA, environmental regulators and other interested stakeholders. This proposal is set out in more detail in chapter 8. As discussed earlier, we
intend to consult later in the year on proposals for general duties and will need to consider further how (and whether) an environmental duty for economic regulation relates to a general environmental duty for the CAA as a whole.

Q6.3 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 airport 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?

6.21. Where airports are competing effectively for airlines and consumers, airport operators have an incentive to provide airport services demanded by their consumers – in terms of quality and capacity – at least cost. Where airports have substantial market power or dominance this incentive is dampened. To ensure airports provide those airport services demanded by consumers at least cost, we propose that the regulator should have a duty to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently. This duty can be seen to build on aspects of the economic regulator's existing duties and is intended to ensure that the regulator takes action to ensure the appropriate airport services are provided as efficiently as possible. 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 consumer representation within the sector (discussed above) will assist the regulator in setting the appropriate service outcomes that best improve the through-airport experience.

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?

6.22. Consumers will generally always prefer to pay lower prices for a given level of service. With a primary duty to promote the interests of consumers, where airports are price controlled, we would expect the economic regulator to be seeking to secure any given level of airport services demanded at the lowest possible cost to consumers. However, one element of this cost is the need to provide a reasonable return on the capital employed in delivering these services. The role of the regulator is therefore to protect the interests of consumers by ensuring that airport operators are provided with sufficient funding to allow an efficient airport operator to deliver appropriate airport services whilst also keeping investment costs to a minimum.
6.23. To reassure investors providing finance to airport operators that efficient investments will be adequately rewarded we propose to place a duty on the regulator to ensure that economic and efficient licence holders are able to finance the activities which are subject to the relevant licence obligations (we discuss the proposed introduction of licenses in the next section). It can be argued that there is no need for an explicit financing duty since it is implicit within the economic regulator’s proposed primary duty to ensure that airport services can be delivered: not providing sufficient funds to enable an efficient operator to deliver the airport services demanded would not be in the interests of consumers. Indeed, under current arrangements there is not an explicit financing duty on the economic regulator. However, we feel that such a duty would provide a firm signal to investors 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.

6.24. In our view best regulatory practice is for the financing duty to be interpreted such that the regulator bases regulatory settlements on the revenues that a notional company would require to finance its functions. This will involve setting the cost of capital assuming a notional capital structure and then ensuring that the company could meet the required ratios (implied by a licence condition to retain a certain credit rating) throughout the control period. During the control period, there would be a presumption that there would be no adjustment as a result of financial distress relating to factors within the control of the operator. In this respect, the introduction of a Special Administration regime can be helpful as it underpins the credibility of the regulator’s position. This represents a clear allocation of risk between the various parties in the regulatory regime and should help to ensure the cost of capital for airport operators accurately reflects the risks involved in their business. The approach is also consistent with the primary duty to promote the interests of consumers as it reassures investors about the reasonableness of the regulator whilst also isolating consumers from the risks associated with the airport operator’s financial structure. This avoids situations where consumers’ interests may be threatened through being asked to bear additional costs associated with financial structures that are not consistent with the efficient and economic operation of the airport.

6.25. There may be other views amongst stakeholders on how the financing duty should be interpreted, in particular in relation to ex ante adjustments, and that this issue remains a matter for further consideration by several regulators. We would like to gain further feedback from these debates and from stakeholders where an alternative interpretation would be favoured. We would therefore appreciate stakeholders’ feedback on how a financing duty should best be interpreted in the context of the airports market.

Q6.5 Given the proposed primary duty to promote the interests of consumers, is a further financing duty required?

Q6.6 What is the appropriate interpretation of a financing duty in the airports sector?
6.26. As discussed in chapter 5, the development of airports can have impacts that are not reflected in airport operators’ commercial cost-benefit analysis. These impacts – both positive and negative – are best taken into account by Government, and in the case of significant capacity expansion projects these will be articulated via the National Policy Statement (NPS) on airports which will guide the decision making of the independent Infrastructure Planning Commission (IPC). The Airports NPS will be subject to an Appraisal of Sustainability which will cover economic, environmental and social impacts of the proposed NPS. It will not simply assess the commercial costs and benefits that an airport operator would consider. It would therefore be inappropriate for the independent economic regulator to take a different view of the case for investment on public interest grounds at the time of publication of the NPS. We therefore propose that the regulator should have a further duty to assist in the delivery of airport infrastructure consistent with the Airports NPS unless there are compelling reasons not to do so. We consider that this duty is important to provide a clear steer on the relationship between the NPS and the economic regulator’s decisions with regard to price regulated airports.

6.27. We propose that where an airport is price controlled, and where an airport operator brings forward development identified in the NPS, the economic regulator, subject to its primary duty to promote the interests of consumers, would be expected to set the price cap at a level to accommodate the delivery of the proposed project. The commercial risks, including passenger demand and project delivery risks, associated with such an expansion will remain with the airport operator. In deciding whether the project would be in the interests of consumers we would expect the regulator to consider consumers’ willingness to pay for the proposed size, specification and timing of the project. The enhanced role of airlines in the regulatory process and improvements to consumer representation within the sector provide the regulator with a sound basis for considering these issues. Where delivery of the proposed project was not consistent with its primary duty to promote the interests of consumers, this would represent a compelling reason not to accommodate the project in the price control. Where, in setting the price control, the regulator proposed to exclude a project proposed by the airport operator, this would be appealable by the airport operator to the Competition Commission. We discuss the details of this appeal mechanism in chapter 8.

6.28. The Review’s Expert Panel – in their advice to the Secretary of State – expressed the proposed duty relating to the NPS using different language, although the intention of the duty remains the same. The Panel’s advice recognised that changes in demand or in costs (including financing costs) may make an investment uneconomic, or delay the date at which it is needed to meet reasonable demands for airport services. In such circumstances, they argue, the achievement of the NPS as originally stated may not be possible or appropriate. They propose that, in these
circumstances, the CAA should have a duty to notify the Secretary of State, before any price control decisions are taken, in order to allow the Secretary of State to consider whether or not to revise the NPS. This is not inconsistent with the way in which the Government expects the new system to operate in practice, although we do not propose to make the CAA’s role in notifying the Secretary of State when the achievement of the NPS is not possible a specific duty in Legislation.

6.29. A key issue in discharging this duty will be the extent to which the regulator is proactive in its activity to assist in the delivery of airport infrastructure consistent with the NPS. Responsibility for scoping and designing an investment project to deliver capacity will remain with the airport operator. The new system would not result in the regulator taking primary responsibility for designing or scoping a capacity expansion project. Nor would the system result in the regulator imposing a licence condition to deliver an investment project that the airport operator thought was not commercial. The regulator would have the ability to engage with the airport operator and to provide incentives for them to bring forward appropriate projects, subject to these projects being in the interests of consumers. Incentives could be provided through, for example indicating that the regulator would be sympathetic to allowing an appropriately scoped proposal to be accommodated within a price control. Once a proposal is made by the airport operator the regulator would decide whether to allow it to be funded through an increase in airport charges following consultation with airlines and other affected parties. If the regulator allowed for an increase in airport charges to fund the development the airport operator would be held to account for the delivery of the project using appropriate licence conditions.

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?

6.30. The final duty we are proposing is that in performing its duties, CAA must have regard, in all cases, to the principles of Better Regulation under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, including any other principles appearing to CAA to represent the best regulatory practice and to consult with stakeholders, including airlines. Table 6.1 describes the principles of Better Regulation. We recognise that the CAA already seeks to follow many of these requirements, but we consider that by including it as a specific duty it will be clear what stakeholders can expect from the CAA with regard to its approach to regulation.
Table 6.1 – The principles of Better Regulation

<table>
<thead>
<tr>
<th>Principle</th>
<th>Description</th>
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<tbody>
<tr>
<td>Proportionality</td>
<td>Regulator should only intervene when necessary and the remedies should be appropriate to the risks posed, and costs identified and minimised.</td>
</tr>
<tr>
<td>Accountability</td>
<td>Regulator must be able to justify decisions and be subject to public scrutiny.</td>
</tr>
<tr>
<td>Consistency</td>
<td>Rules and standards must be joined up and implemented fairly.</td>
</tr>
<tr>
<td>Transparency</td>
<td>Regulators should be open, and keep regulations simple and user-friendly.</td>
</tr>
<tr>
<td>Targeted</td>
<td>Regulation should be focused on the problem and minimise side effects.</td>
</tr>
</tbody>
</table>

6.31. It is now also part of the Government’s better regulation agenda to ensure that regulators’ review the burdens they impose, reduce any that are unnecessary and unjustifiable and report on their progress annually. We therefore propose to amend the Regulatory Enforcement and Sanctions Act 2008 so as to apply Part 4 to the economic regulatory functions of the CAA or add the duty directly through primary legislation. This will 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.

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.
Governance

6.32. We recognise that part of ensuring that the new regulatory regime is fit for purpose and delivers outcomes that further passengers’ interests is to ensure that the governance of the CAA as a whole is fit for purpose and corresponds to best practice. We have noted the emphasis placed on this issue by the Expert Panel in its recommendations to the Secretary of State. Issues associated with the governance of the CAA have been considered by Sir Joseph Pilling, and the Government has accepted his recommendations concerning the future structure of the CAA. Therefore, this consultation does not consider further or in detail specific aspects of the governance of the CAA.

6.33. By accepting Pilling’s recommendations the DfT will replace the current structure of the CAA with a Board headed by a non-executive Chairman, which has full responsibility for all of the CAA’s decisions, including those relating to economic regulation, and led by a Chief Executive who will be its principal public face. This is consistent with the structure of other UK economic regulators and as this transition is now in progress we are not seeking views on it as part of this consultation.

Summary of key proposals

6.34. In this chapter we have set out proposals for a new primary duty for the CAA with regard to economic regulation that will clearly focus on the interests of consumers of passenger and freight air services. The Government believes that consumers’ interests are generally best promoted by the development of well functioning competitive markets, and this is also reflected in the proposed primary duty. To supplement the primary duty and provide clarity about the other factors that the CAA should consider when developing proposals for economic regulation we are proposing a number of further duties that cover environmental issues, meeting reasonable demands economically and efficiently, the ability of airports to finance their licensed activities and the interaction with the NPS and achievement of better regulation outcomes. We welcome views on each of these proposals.

6.35. The next chapter explains the enforcement mechanisms, including the proposed new licensing regime that will give the CAA the powers to achieve its statutory duties.
7. Designing a flexible, fair and effective enforcement regime

Introduction

7.1. As well as setting a clear and focused set of objectives for the regulator, through framing its statutory duties, reform to the current regime must also include a robust but flexible set of tools for the regulator to use in pursuing these objectives, and in particular to promote the interests of consumers. This chapter sets out the proposals to reform the regulator’s toolkit in order to maximise the regulatory framework’s ability to deliver good outcomes for consumers.

7.2. The proposed new regime seeks to empower the CAA, subject to appropriate checks and balances, to determine the most appropriate regulatory arrangements to further the interests of consumers.

7.3. The remainder of this chapter:

- Discusses the main components of a flexible, fair and effective regime for intervention;
- Sets out the proposals for the new licensing regime for UK airports;
- Discusses initial proposals for the content of the licenses, including the provisions within the Airport Charges Directive;
- Explains the proposed approach to developing the initial licenses;
- Sets out proposals for how licence conditions could be changed;
- Sets out proposals for the sanctions and enforcement powers that would be available to the CAA; and
- Sets out proposals for giving the CAA concurrent competition law powers with the OFT.
Facilitating flexible, fair and effective intervention

7.4. The evidence the Review has received suggests that the existing economic regulation regime is considered by a broad range of stakeholders – including airlines, airports, the CAA, and the Competition Commission – to be insufficiently flexible. It prescribes the timing of price-control periods to a 5-yearly cycle and limits the ability of the regulator to intervene flexibly between price-control periods. In addition, the current system limits the range of interventions that the regulator can choose from in pursuing its statutory remit as the legislation is framed around its duty to set price controls. Though this does provide the regulator with some flexibility to design the price control process and to introduce processes such as Constructive Engagement to help set price caps, it does not clearly give the regulator the powers to make interventions beyond and between price control reviews that could enhance outcomes for consumers. For this reason, a service quality regime was not introduced until the Competition Commission had found BAA's service quality performance to be against the public interest."

7.5. The alternative to the current rules-based system is to introduce a licence-based regime for economic regulation in the airports sector. This would prohibit the operation of specific airports without a licence. The licence would allow the regulator to place obligations on the airport operator that are consistent with the regulator's statutory duty to pursue the interests of consumers. The ability to introduce obligations on the airport would be a more flexible mechanism allowing the regulator to introduce ex ante price and service quality regulation where necessary and to control, influence, prohibit or require other conduct where this was in the interest of consumers or in pursuit of its further duties.

7.6. In common with current practice, the CAA would design price controls with a view to providing the industry with a high degree of regulatory certainty to promote investment. However, there would be no binding obligation to follow a 5-year cycle. This would allow a longer-term price commitment to be made in certain circumstances where this was seen as a way to promote investment in the interests of consumers and increase operating and capital efficiencies of the licence holder. In addition, the regulator would have the ability to modify licence obligations to meet new circumstances. For example, there would be the ability to alter service quality obligations on the airport to address problems that arise between price control periods, subject to appropriate appeal mechanisms (as discussed below). We would expect that this ability would allow the regulator to influence more decisively to deliver good outcomes to passengers when unexpected events result in poor passenger experience. An example of such circumstances is the introduction of stricter security rules in 2006 to address the elevated terror threat. A more flexible licence regime could have helped the regulator to intervene in a targeted way to ease the transition to the new rules.

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64 See http://www.dft.gov.uk/pgr/aviation/airports/reviewregulatioukairports/callforevidence/summary
65 See http://www.caa.co.uk/docs/5/ergdocs/ccreportbaa/chapter2.pdf
7.7. The regulator would be able to choose from a wider range of potential regulatory interventions as it could introduce bespoke solutions to meet any problem as long as these were consistent with its statutory duties. As discussed below, it is important that these new and greater powers for the CAA are accompanied by appropriate checks and balances.

7.8. Stakeholders, including the regulator, airports, airlines and others, were supportive of the introduction of a licensing regime, although suggestions for the specific form of the regime differed. The CAA noted that a licence-based framework would provide a mechanism to allow regulation to be proportionate. It would also allow the regulator greater flexibility. London First also noted the greater flexibility of a licensing regime. In particular, London First noted that such a regime would strengthen the regulator’s ability to act between price control reviews.

7.9. Given these advantages, we propose to introduce a licence-based system for the economic regulation of UK airports. In this section we outline the detailed design of a flexible licence-based system for UK airports regulation. This design will include provision for affected parties to challenge regulatory decisions made within the licence structure that will enhance transparency and improve stakeholders’ ability to hold the CAA to account if it considers that its decisions do not fulfil its statutory duties. The move to a licence-based system will bring the economic regulation of airports into line with other more modern economic regulatory regimes in the UK such as energy, water and rail where licence regimes are well established and have proven to provide the regulator with greater flexibility than the CAA has been afforded.

7.10. Where our thinking on the detailed design of the licence is still being developed we have posed some questions for consultation upon which we would particularly value stakeholders’ feedback. If legislation is passed introducing a licence regime there would be further consultation with affected stakeholders on the appropriate design of individual licenses at each licensed airport.

A proportionate licence structure

7.11. In line with the principles of Better Regulation, we are proposing to introduce a targeted and proportionate set of reforms that will not extend the intensity of regulation beyond where it is necessary. To this effect we propose that the licensing regime be tiered on the basis of clearly defined criteria. This approach recognises that airports of different sizes and different levels of market power will need to be subject to different licence obligations. To this effect the proposed licence system would split UK airports into 4 categories:

- **Tier 1 licensees** – Airports with substantial market power or dominance and for which general competition law is unlikely to be sufficient to address the potential risks of abuse of market position. Following the de-regulation of Manchester airport from price regulation on 1 April 2009 there will be three airports – Heathrow, Gatwick and Stansted – that are regulated due to their market position (the designated airports).
- **Tier 2 licensees** – Airports with more than 5 million passengers per year (currently 13 UK airports including those subject to Tier 1 licence). These airports would be covered by provisions within the EU Airports Charges Directive (we discuss the potential for implementing the Directive using the economic licence later in the chapter).

- **Tier 3 licensees** – Airports with special conditions. The CAA would be granted the power to introduce licenses at airports with less than 5 million passengers per year, and place them in Tier 3. 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. This would also provide a means for airports with high freight volumes relative to passengers to be subject to some form of economic regulation if the CAA deemed it necessary. Assuming no airports were immediately placed in Tier 3, these proposals would initially mean that 42 airports which under the current regime have to seek permission to levy airport charges would not need an economic licence to operate.

- **Airports not regulated by an economic licence** – Airports providing a service to less than 5 million passengers per year which do not have substantial market power, and not identified by the CAA as appropriate for a Tier 3 licence.

**7.12.** We propose that the regulator will retain the ability to bring Tier 2 and Tier 3 licensees into Tier 1 where this was deemed appropriate, subject to meeting the appropriate criteria and the potential for affected parties to appeal a decision to the Competition Appeals Tribunal (as discussed below). This allows small airports that have substantial market power or dominance to potentially be subjected to firm licence obligations commensurate with their strong market position.

**7.13.** We propose that the decision on airports’ transition into and out of the Tier 1 licence will be made by the regulator based on whether the airport in question meets the first two criteria set out in the existing designation criteria along with a revised third criteria relating to the proportionality of regulation. The proposed criteria are set out below:

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

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66 Negotiations on the draft Directive are complete, and it is expected to become EU law in Spring 2009. Member States then have 24 months to implement it.

67 The DfT believes this approach is an appropriate response to the CC’s concerns about small isolated regional airports – such as Aberdeen – expressed in the context of their BAA Market Inquiry.

68 In deciding whether an airport should be included in Tier 1 an assessment will need to be made about whether the airport has ‘substantial market power’. The Office of Fair Trading’s website includes guidance about how the concepts of market power and dominance should be assessed.
3. Regulatory intervention within the Tier 1 licence will deliver additional benefits for airport consumers (i.e. over and above competition law) that exceed the costs and potential adverse effects of any regulatory intervention.

7.14. We propose that the criteria against which airports are assessed to enter, remain, or exit Tier 1 should be set in Primary Legislation. We have proposed this approach because we consider that the approach to deciding which airports should have a Tier 1 licence is a particularly important decision that should be made on the basis of clearly understood criteria. By implementing the criteria through Primary Legislation this would provide a degree of regulatory certainty and transparency around this decision. We believe that this would be beneficial in the long term for investment outcomes in the sector.

7.15. In general, we recognise that the potential consumer benefit to be gained from imposing price controls or intervening in service quality at smaller airports might be expected to be relatively small (due to lower passenger volumes), especially when set against the potential costs to industry and the regulator that such action may require. For these reasons we expect that the introduction of such interventions at small airports (those that service less than 5 million passengers per year) will be relatively rare, although we believe that there is merit in retaining the option of intervening in this way. In particular, we would expect that the existence of this option will ensure that airports in this category will use restraint in benefiting from their market position so that its exercise will be infrequent. We would welcome stakeholders’ input on the proposed approach to regulating small geographically isolated airports in the new regime.

7.16. An intermediary step prior to the introduction of a Tier 1 licence for a small airport where there were material concerns over its conduct would be for the CAA to impose special conditions using a Tier 3 licence. We propose that the CAA should be given the option of imposing special conditions on small airports – for example obligations to consult with airlines over prices and measures to ensure price transparency – where it has good cause to do so. An example of evidence that would provide good reason to introduce a Tier 3 licence would be complaints from passengers, freight users or airlines that upon investigation identify specific price or service quality problems that justify intervention. We propose that the CAA’s decision to impose a Tier 3 licence would be subject to a merits-based appeal by the airport operator in question to the Competition Commission. We would welcome feedback from stakeholders on whether a more formal or specific mechanism is necessary to manage airports’ entry into a Tier 3 licence and on the proposed appeal mechanism for CAA decisions on this matter.
7.17. For the avoidance of doubt, we do not propose that the introduction of a licence-based regime for economic regulation in the airports sector would terminate, revoke, suspend or modify the existing permission to levy airport charges at Heathrow and Gatwick airports or the basis on which the current price caps at Heathrow and Gatwick airports are set, including the price cap which will be applicable to Stansted airport with effect from 1 April 2009. The intention of the proposed reforms is to introduce a more flexible regulatory system, in addition to the existing permission to levy airport charges, to the current regime, which focuses mainly on five-yearly price-controls, is regarded as insufficiently flexible.

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 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?

Content of licenses

7.18. In this section we outline the type of licence conditions we believe could be imposed in the various licence tiers. This is not intended to specify the precise form of licenses across the tiers or at specific airports. This discussion is intended to provide clarity on the range of conditions that we believe might be appropriate options for inclusion in licenses across the different tiers. The feedback we receive from stakeholders on these proposals will assist the DfT in designing appropriate legislation to implement reform. In addition, in the event that legislation implementing a licence structure is enacted, stakeholders’ views will influence the design of initial licenses. Stakeholders will have a further opportunity through consultation to comment on the initial design of licenses.
7.19. In developing these proposals we have had particular regard to the views of the Expert Panel, the provisions contained within the Airport Charges Directive and noted the views on these issues in the Competition Commission’s Provisional Decision on Remedies for its Market Investigation. The section below summarises the anticipated content of licenses across the different tiers. The discussion then moves on to the dynamics of the proposed licence system including how the initial licenses will be established, how they can be changed, and what powers the CAA will have to sanction for non-compliance with licence conditions. However, before we consider these issues it is important to consider the potential implications of the Airport Charges Directive for the economic regulation of airports.

Airport Charges Directive

7.20. Airport charges at a number of UK airports are to be subject to new legislation arising from Europe by Spring 2011. An Airport Charges Directive (ACD) has been negotiated by Member States, the Commission and the European Parliament over the past two years and is expected to become EU law in Spring 2009. Once this has happened, the UK, and other Member States, have 2 years to implement the Directive’s provisions.

7.21. The ACD will apply to all airports with more than 5 million passengers per annum. In 2007, there were 13 UK airports with more than 5 million passengers per year: Heathrow, Gatwick, Stansted, Manchester, Luton, Birmingham, Edinburgh, Glasgow, Bristol, Newcastle, Liverpool, Nottingham East Midlands and Belfast International.

7.22. The Directive 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.

69 In the Airport Charges Directive the phrase ‘airport user’ is defined as – ‘any natural or legal person responsible for the carriage of passengers, mail and/or freight by air from or to the airport concerned.’
Designing a flexible, fair and effective enforcement regime

- 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.

- A right of appeal for an airline – under certain circumstances, to the independent regulator if it does not agree proposed changes to the level or structure of airport charges. The UK intends to use the derogation in the Directive that permits Member States not to implement the right of appeal if their own systems of airport regulation identify where there is ineffective competition and, if warranted, introduce price capping or the approval of charges. The proposed test for moving between a Tier 2 and Tier 1 licence (see paragraph 7.13) sets this out.

7.23. Should a licence-based approach to the economic regulation of airports be introduced, there seem on the face of it good arguments for implementing a number of the ACD’s requirements on airport managing bodies through economic licence conditions. This approach seems well suited, for example, to the Directive’s provisions requiring airports to consult with and provide information to airlines. Implementing the ACD’s requirements on airports through licence conditions would avoid the need for separate systems for UK and EU based regulation, reducing the potential for overlapping and/or inconsistent requirements.

7.24. Use of licence conditions would not be the only way in which the ACD is permanently implemented as some of its requirements are directed at Government, the independent regulator and airlines.

7.25. Primary legislation would be required to implement the ACD using the licensing approach. Although the Government is inclined to pursue Legislation in this area as a priority, the timing remains uncertain, and the content subject to agreement by Parliament. Given this position, it is not certain that a licensing system will be in place by Spring 2011, when the ACD has to be implemented in the UK. In light of this, the DfT intends to consult stakeholders later in 2009 on how precisely the ACD could be implemented by Spring 2011 against the background of the current airport regulation framework established by the Airports Act 1986. This consultation is also expected to consider further how the ACD’s provisions would be accommodated if, and when a licensing approach is put in place. We set out our initial proposals below.

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?
Licence conditions

7.26. **Tier 1 licence** – the DfT expects that Tier 1 airports would be subject to the following obligations (in addition to the provisions of the Airport Charges Directive, where relevant):

- Price regulation – the form of price regulation could range from the standard RAB-based price cap through to the lightest touch option of price surveillance. A discussion of the practical issues relating to the operation of price controls under the proposed licence system is set out in chapter 9.

- Measures to enhance the financial robustness and resilience of the operator. These interventions would be designed to require the licensee to have the necessary resources to meet the needs of the regulated business and might include:
  - Limiting the circumstances in which owners can take cash out of the regulated business, diversifying into potentially loss-making businesses, or charge its assets if to do so will put it at risk of failing to finance its functions. These are similar provisions that are often required by lenders.
  - Obliging the licensee to confirm on a regular basis that it has adequate resources to operate the business in accordance with the licence. This will require the directors to pay dividends out of the business at a conservative level consistent with the regulated business retaining adequate resources to meet its obligations.
  - Obliging the licensee to maintain an investment-grade credit rating for the regulated business – this will discourage excessive gearing and the consequent risk to financial stability, and will – where necessary – encourage equity injections/disposals to enable investment.

Where applied these provisions would not extend beyond the regulated business. We recognise that careful consideration will have to be given to the method of introduction and implementation of such measures, in the light of airports’ current financing arrangements. Further discussion of how the proposed licence system might be used in this context is set out in chapter 9.

- Obligation to consult with airlines and other stakeholders on future plans for investment in, and the operation of, the airport. The DfT envisages that the CAA’s role in facilitating airport-airline dialogue and negotiation on plans for airport service delivery will be a key feature within the new regime with the regulator taking on a proactive role to facilitate appropriate information flows and to intervene where necessary to decide on issues relating to airports’ investment programmes. A discussion of the practical operation of this airport-airline interaction in the new regime is set out in chapter 9.
● Obligations to report on environmental performance. This would be available to the scrutiny of the CAA, environmental regulators and other interested stakeholders with the purpose of providing a basis for on-going engagement between the airport and the local communities that they serve. Further discussion on the details and purpose of the proposed environmental reporting obligations are set out in chapter 8.

Subject to considering the views expressed by stakeholders the DfT is presently minded to propose Legislation that makes it clear that Tier 1 licensees should be subject to the obligations outlined above.

7.27. In addition, we expect that Tier 1 licenses would also usually include – subject to the specific circumstances at the airport in question – the following conditions:

● Obligation to comply with service quality standards. Effective economic regulation is not just about price regulation. To protect consumers the regulator needs the ability to intervene decisively to ensure Tier 1 airports’ price-setting ability is not manifested in artificially low investment or poor levels of service.

● Capacity utilisation limits to ensure delays are kept to an efficient level. The ability for the regulator to set such limits will help the industry to avoid getting into the current problems of over-crowding at Heathrow airport which has resulted in an inefficiently high level of delays.

● Measures to hold the airport operator to account for the delivery of agreed investment outputs, including investment in capacity.

● To provide regulatory accounting information and other information as required for the effective operation of the Constructive Engagement process.

7.28. We do not intend to bind the regulator into imposing these conditions at all Tier 1 airports in all circumstances. After the initial licenses have been established by the Secretary of State, decisions on the imposition of these types of condition – and any other conditions that would be consistent with the regulator’s statutory duties – would be made on a case-by-case basis by the regulator with reference to the particular circumstances at the airport in question.

7.29. **Tier 2 licence** – The initial licence conditions would relate to the provisions contained within the EU Airports Charges Directive (ACD). As Tier 2 airports would be subject to effective competition, the provision within the Directive providing airlines with a right of appeal to the regulator on proposed changes to the structure or level of airport charges would not apply. In addition to implementing provisions of the ACD, we propose environmental reporting obligations for Tier 2 airports of the same type as those discussed above in relation to Tier 1 airports. We propose that the content of the initial Tier 2 licenses will be generic across the Tier but that the CAA should have the ability to modify licence conditions once licenses are established as appropriate to meet its duties. Licence modifications would be subject to the appeal mechanism.
7.30. **Tier 3 licence** – We propose that Tier 3 airports could be subject, at the discretion of the regulator, to any or all of the obligations that would be applied at Tier 2. This would allow the regulator to potentially apply more strenuous conditions on small geographically isolated airports if it was found that their market position warranted this and the benefits of further intervention outweighed the costs. If a small airport was found to meet all the criteria for entry to Tier 1, Tier 3 licensees could be shifted into Tier 1 and subjected to the full suite of conditions as necessary to protect consumers.

Q7.3 We would welcome comments on these initial thoughts about the conditions that should be included in the licenses 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?

### Developing the initial licence

7.31. If Legislation is passed to bring into effect a licensing regime, it will be necessary shortly thereafter to issue initial licenses to the relevant airports. The initial licenses would be issued by the Secretary of State for Transport, meaning that the Secretary of State had the final power of decision about what was included. This is consistent with the approach in a number of other UK regulated sectors, including energy. We believe that the first licenses are particularly important as they will set a strong precedent on how the regime will operate in the future. Given the pivotal importance of these initial licenses it seems appropriate that the democratically elected Secretary of State has the sign-off power. This will allow Government to check that the new licenses are appropriately designed to meet the function that Parliament envisaged when it passed Legislation and if satisfied to signal firm backing for the new licence regime prior to its initiation.

7.32. We propose that the DfT and the CAA work collaboratively in the development of draft initial licenses along with key government, and other stakeholders. The CAA would be asked to provide advice to the DfT (under section 16 of the Civil Aviation Act 1982) on the appropriate contents of licenses. As part of this process the draft licenses would be published for substantive consultation with stakeholders. Draft licenses would then be submitted to the Secretary of State for issue. If he was so minded to amend the draft licenses we envisage that the Secretary of State would consult on the proposed amendments prior to the licenses being issued.

7.33. In exercising his power in relation to economic regulation the Secretary of State would be subject to the same duties as the CAA. This would mean any appeals against the Secretary of State’s interventions in the new system could be dealt with in a common way to appeals against the CAA’s decisions.
Changing licence conditions

7.34. Once the initial licenses are in place there will need to be provisions to allow modifications to be made to licence conditions to allow the regulatory regime to flexibly react to changes in circumstances. A major advantage of the licence system is that it should facilitate a quicker and more transparent means of altering regulatory interventions to meet the needs of consumers than a regime based on primary legislation only.

7.35. Broadly, we are proposing that consistent with other regulated sectors, a licence modification would be proposed by the regulator and if this was accepted by the licensee(s) the modification would come into effect. If the modification was opposed by the licensee, the matter could be referred to the Competition Commission by the regulator, which would reach its decision on the basis of the duties applying to the CAA, and whose decision would determine the outcome. Where a proposed modification of a licence condition would apply identically to a number of airports (collective licence modifications), for instance all the airports with a Tier 2 licence, we recommend that this modification would come into effect if it was accepted by a large proportion of the affected airports using appropriate measures of size. If it was not accepted on this basis the CAA could refer the matter to the Competition Commission for consideration.

7.36. We consider that it is appropriate for the CAA, as the independent regulator, to have the sole power to initiate proposals for licence modifications. This does not preclude other parties asking the CAA to consider making certain licence modifications on an informal basis.

7.37. We consider in chapter 8 proposals for how appeals regarding CAA decisions should take place. We are proposing that the licence holder would always have the right of appeal, but we are also seeking views on whether the right of appeal should be extended to other parties with a material interest. If this proposal is introduced then there would need to be an additional stage in the process of licence modifications to allow the relevant parties an ability to trigger a Competition Commission consideration of the issue.

7.38. For collective licence modifications, we would welcome views on the appropriate basis for changes being accepted. Our initial thoughts are that 80% of affected airports, and airports accounting for 80% of annual passenger numbers should be needed to support the change for it to take effect. Such relatively large percentages are intended to ensure that this process is only used to make licence modifications for which there is broad consensus about the merits of the proposal, as otherwise the matter should properly be subject to consideration by the Competition Commission if the CAA wishes to make the change. By requiring a set percentage of both the number of airports and passenger numbers we are seeking to ensure that if there is a very large airport within a particular tier it cannot effectively ensure that a particular change is made, albeit it could block a change being made.

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71 Other regulatory regimes that follow this approach include those in the water, energy and rail sectors. References for the relevant provisions for agreeing licence modifications with the consent of the licensee in these regimes are – S17 Water Industry Act 1991, S23 Gas Act 1986, S11 Electricity Act 1989, and S12 Railways Act 1993.
Alternatively, collective licence modifications might be imposed if a lower threshold of, say, 50% of affected airports, and 50% of annual passenger numbers. Our initial view is that this would make it too easy for a large airport or group of airports to ensure that a licence modification is accepted. This would create a risk that smaller airports within the Tier are unfairly denied access to appeal decisions that might impact upon them disproportionately and put them at a commercial disadvantage. In addition, one might frame collective licence modifications on the basis that all affected airports had to agree a change. Our initial view is that this would lead to an unnecessarily high level of challenges as it would only take a single airport to be dissatisfied for a challenge to be considered. For these reasons the DfT proposes a threshold of 80% of airports accounting for 80% of passenger numbers strikes a good balance between providing accountability on the regulator whilst avoiding unnecessary challenge.

We expect that in the case of proposed licence modifications the regulator would consult affected parties before making a change, and it will be a legal requirement for the CAA to hold such a consultation. This would also be consistent with the proposed statutory duty within the regime to follow better regulation principles and to consult with stakeholders.

We are aware that in other sectors, including in the water and energy sectors, legislation has retained powers for the Secretary of State to intervene in decisions to change licence conditions. In the water regime the Secretary of State has the ability to veto proposed modifications in limited circumstances and can block a proposed modification if they believe the proposal should be referred to the Competition Commission prior to implementation, even where agreed with the licensee. In the electricity and gas regimes, the Secretary of State has an absolute veto on proposed modifications to standard licence conditions. These powers allow the Secretary of State to have some role to ensure that licence condition changes are rigorously checked for consistency with the interests of consumers before their introduction. Similarly, in the rail sector the Secretary of State for Transport has the ability to veto the reference to the Competition Commission of licence modifications which would operate or may be expected to operate against the public interest. This provides a mechanism for the Secretary of State to intervene if he believes changes are not in accordance with his statutory duties (in relation to rail), one of which is to protect the interests of users.

We propose that the Secretary of State would retain a power to refer future licence modifications to the Competition Commission, even where the licensee agrees to their imposition. We believe this will provide a useful check on regulatory decisions that will guard against the regulator being captured by the industry and making a decision contrary to passengers’ interests. We do not believe a stronger power to intervene would be appropriate as we recognise the benefits independent regulation provides in terms of certainty for investment and therefore want to limit and restrain the scope for ministerial intervention.
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?

Issues relating to appeals on licence decisions are discussed in chapter 8.

Sanctions and enforcement of licence conditions

7.43. We have considered the sanctions that should be available to the CAA under the new framework for economic regulation of UK airports in order to ensure that the CAA is able to promote compliance with its decisions and the terms of the licenses by airport operators. As noted in the Macrory review “[s]anctions are an important part of any regulatory system. They provide a deterrent and can act as a catalyst to ensure that regulations are complied with.” Furthermore, clear sanctions provide clear guidance to those who are subject to regulation as to standards of conduct that must be observed.

7.44. We have followed some broad principles to develop proposals for sanctions:

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

- A regulator, in this case 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 who they apply to, 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, and the nature and quantum of the sanction.

- 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 (“RESA08”).

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7.45. The Macrory review suggests six “penalties principles” that should inform the design of sanctions under any new framework for airport regulation and has provided useful guidance in the design of any regulatory structure. These penalties principles hold that sanctions should aim to: change the behaviour of the offender; eliminate any financial gain or benefit from non-compliance; be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma; be proportionate to the nature of the offence and the harm caused; restore the harm caused by regulatory non-compliance, where appropriate; and, deter future non-compliance. In addition, the Macrory review set out a framework of seven “characteristics” in which the penalties principles listed above should operate. These characteristics would encourage regulators to publish an enforcement policy, measure outcomes not just outputs, justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament, follow-up enforcement actions where appropriate, enforce in a transparent manner, be transparent in the way in which they apply and determine administrative penalties and avoid perverse incentives that might influence the choice of sanctioning response.

7.46. We have also considered the range of sanctions available to other economic regulators within a licence regime. Each of the water, gas, electricity, rail and 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 the regulator comprise the issue of an enforcement order, the imposition of a penalty and/or revocation of the licence.

7.47. Some stakeholders commented on potential sanctions for breach of licence conditions. The CAA did not have any specific views on the form of potential sanctions but saw no reason why these should not be in line with sanctions defined for other regulated sectors in the Utilities Act 2000 – that is, a fine of up to a specific percentage of turnover. MAG also noted that sanctions for breach of licence conditions could include financial penalties of a sum up to a certain percentage of turnover.

7.48. Enforcement Orders, both provisional and final are used as the first step in enforcing breaches of licence conditions, failure to meet performance standards or failure to pay certain charges. We propose 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 has been served are required to be given time to make representations and objections in respect of the order. Once an order has been made, only the licence holder on whom

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73 See page 10, Macrory review.
74 The NATS regime does not provide for penalties.
75 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.
76 Also, prior to revoking an enforcement order, the parties are required to be given at least 28 days to make representations/objections to the revocation.
the order has been imposed would be able to appeal to an appropriate chamber within the First-tier Tribunal of the new Tribunal Service.” The First-tier Tribunal would have power to quash the order, or any provision of the order, or uphold it. The First-tier Tribunal cannot, however, impose its own order.” 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 we believe will provide a suitable venue and level of expertise to efficiently handle appeals on sanctions. We would welcome stakeholders’ feedback on this proposed approach to the imposition and challenge of enforcement orders.

7.49. In each of the other regulatory regimes which we considered, 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 some kind of 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. In the water, gas, electricity, and communications regimes the maximum limit for a financial penalty is set in statute at 10% of the relevant undertaking’s annual turnover.” 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 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 on timing 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.

7.50. 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 we propose that this process is adopted for the new legislative framework.

77 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 Government where the tribunal has been given jurisdiction.
78 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.
79 There are some subtle differences in the definition of what the relevant ‘turnover’ is relating to the relevant activities. 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’.
7.51. In each of the other regulated regimes which we considered, the licence contains 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. 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.

7.52. The 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 new airport services regulatory framework will require revocation provisions within the terms of each licence and we would propose that the provisions for revocation follow closely the provisions in other regulated licenses as summarised briefly above. We are not aware that there are any material concerns with the revocation provisions applicable in other regimes which may affect its consideration but would welcome comments on this. Particular consideration should be given to whether there are other grounds for revocation specific to airport services which should also be included with the revocation terms and we would welcome comments on this.

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?

Would a maximum financial penalty for licence contraventions of 10% of the relevant undertaking’s annual turnover be an appropriate upper bound?

Are there any particular features of the airports sector that would justify or require a different approach to licence revocation?

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For example, in the Water Regime, certain licenses contain provisions which allow for revocation where the licence holder has contravened a duty under their licence or where a manager or employee has been convicted of a criminal offence material to the supply of services. Some Communications and Rail licenses contain provision for revocation where there is a change of control and the new controller is not deemed to be a suitable licensee.
Concurrent competition powers

7.53. Under sections 41(2) and (3) of the Airports Act 1986, the CAA has powers to control anti-competitive behaviour by airports. Under these provisions, the CAA has the power to impose discretionary conditions on an airport operator’s permission to levy airport charges if the airport operator is pursuing an anti-competitive course of conduct which broadly includes:

- unreasonable discriminatory pricing policy;
- unfair exploitation of bargaining power;
- predatory pricing;
- unreasonable discrimination in the granting of rights.

7.54. Airport operators are also subject to the provisions of Chapter I and Chapter II of the Competition Act 1998 (CA98) and Articles 81 and 82 of the EC Treaty. These provisions control anti-competitive behaviour in markets through prohibitions on anti-competitive agreements and the abuse of dominance. The provisions are enforced in the UK by the Office of Fair Trading (the OFT). In addition, under the Enterprise Act 2002 (EA02) there are powers to make market investigation references to the Competition Commission where a market appears to have anti-competitive features.

7.55. When the CA98 was introduced, many regulators including those for telecoms, electricity, water and gas were given concurrent powers to act across all of the regulated sector covered by that regulator. Since that time, detailed procedures have been agreed and published which deal with the operation of concurrent powers in practice. The CAA was not, however, given concurrent powers at the time when the CA98 was introduced. In February 2001 the CAA acquired concurrent powers under Chapter V of the Transport Act 2000 (“the TA00”) to enforce provisions of the CA98 and the EC Treaty. The CAA also acquired limited powers to make market investigation references under the EA02. However, these powers do not apply to airport services but apply only to the supply of air traffic services.

7.56. A number of stakeholders suggested that the CAA should be given concurrent powers. For example, the CAA considered that it should have the flexibility to decide in any particular case whether sectoral or broader competition powers should be applied. It therefore supported the Competition Commission’s views that the CAA should be given a full range of concurrent competition powers for airports. MAG agreed that the CAA should be given concurrent competition law powers. The Northern Way thought that giving the CAA concurrent competition law powers would be in line with the practice in most other regulated industries and would appear to be a sensible approach.

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81 See section 54 and Schedule 10 CA98. 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.

82 The detailed procedure for determining which body is well placed to act in a particular case of an alleged breach of competition law is set out in The Competition Act 1998 (Concurrency) Regulations 2004 (SI 2004 NO1077). The OFT and the regulators also liaise through a Concurrency working party (“CWP”) and the OFT has published guidance on the scope and use of concurrent powers by regulators.

83 See sections 85 and 86, TA00 and sections 23-26 at Part 2 of Schedule 9, EA02.
7.57. As part of the review of airport regulation, we have given consideration to whether it is now appropriate for the CAA to be given concurrent powers in relation to airport services. There are a number of arguments as to why concurrency is desirable 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 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.

7.58. The CAA has argued that under a licensing regime, effectively to trade off sectoral regulation through licence conditions and regulation through monitoring and ex post enforcement of the competition law rules, the CAA would need general concurrent powers to enforce competition law in airport services markets. “The CAA has subsequently suggested that the precise scope of the concurrent powers should be in relation to activities related to the supply of airport infrastructure.” The House of Lords in its Report on Economic Regulators published in November 2007 also recommended that regulators should in principle all hold concurrent powers.

7.59. It appears anomalous to have two separate and parallel systems currently regulating anti-competitive conduct by an airport in the UK. On the one hand section 41 AA86 enforced by the CAA; on the other hand the CA98/Articles 81 and 82 enforced by the OFT. Extending the concurrent powers of the CAA to apply to airport services as well as air traffic control services would provide the CAA with additional powers to regulate airport operators. It would enable the CAA to consider whether to use its sectoral powers or its competition powers in particular instances and would provide the CAA with the power to impose civil penalties or accept undertakings or other CA98 sanctions as appropriate.

7.60. We recognise that the current arrangements have not obviously led to poorer outcomes for consumers. “However, we believe that granting the CAA concurrent powers to enforce competition law in relation to airport services will improve the current situation. This reform would allow the CAA to use a full range of tools likely to be needed to ensure the efficient and competitive provision of airport services, and protect passengers’ interests under any future system of economic regulation. We would welcome input from stakeholders on whether ‘airport services in the UK’ is the appropriate definition for framing an extension of the CAA’s concurrent powers.

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84 CAA submission to the CC on the Economic Regulation of UK Airports (February 2008), para 5.44. CAA response to DIT’s call for evidence in July 2008 (para 4.8).
85 The DIT invited the CAA to consider whether there would be merit in them being granted concurrent powers to apply competition law in relation to airlines. The CAA indicated that it does not believe there is an overall benefit in concurrent powers to enforce Competition Act and EC Treaty powers being extended to airline markets but that it has not yet concluded if concurrent powers to make market investigation references in relation to airline markets would be beneficial. This consultation document concerns airport services markets so we do not comment in detail on this issue in this document. Any comments on this issue from third parties would however be welcome.
86 A House of Lords report UK Economic Regulators (November 2007) noted that where regulators do not have concurrent powers, the liaison between the regulator and the OFT was satisfactory and the regulators did not consider that the lack of concurrent power had hampered their effectiveness.
In relation to appeals against the exercise by the CAA of concurrent powers, appeals of competition decisions under the Competition Act 1998 are made directly to the CAT. Any party to an agreement in respect of which a regulator has made a decision, any person in respect of whose conduct a regulator has made a decision, and any third party who the CAT considers has a sufficient interest in a decision made by the CAA can appeal the decision on its merits. The possible remedies are for the CAT to confirm or set aside all or part of the decision, to refer the matter back to the regulator, to impose, revoke or vary the amount of any penalty, give such directions, or take such other steps as the regulator could have given or taken, or make any other decision which the regulator could have made. We believe these procedures operate effectively in other economically regulated sectors and that CAA decisions made under concurrent powers should therefore be subject to challenge under the same rules and procedures to which the OFT and other concurrent regulators are subject.

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

Summary of key proposals

In this chapter we have set out proposals:

- To introduce a new licensing regime for UK airports with three tiers of licenses. Tier 1 licence holders would be those with substantial market power or dominance. Tier 2 licence holders would be those airports with more than 5 million passengers per year (relevant provisions would also apply to Tier 1 airports). The CAA would have powers to licence other airports under Tier 3 where they considered it necessary to meet their statutory duties.

- Regarding the conditions that might be included in the initial licenses, and propose that the Secretary of State has the power to issue the initial licenses.

- For the process of changing licence conditions, including different processes for changing a licence condition in one airport’s licence and making a modification to a licence condition for all airports in a particular tier.

- About the sanctions that CAA should have available to enforce compliance with the licensing regime.

- To give the CAA concurrent powers to apply competition law to airports along with the OFT.

The next chapter consults on proposals and options to ensure sufficient accountability for decisions in the new regulatory framework.
8. Enhancing accountability

Introduction

8.1. This chapter sets out proposals for how the regulator should be held to account for its decision making and its general performance in a new regulatory regime. The most important mechanism for ensuring regulatory accountability is ensuring there is appropriate provision for affected stakeholders to challenge the CAA's decisions to an independent body. We believe that the lack of an appropriate merits-based appeals mechanism in the existing regulatory system is one of its most fundamental shortcomings. The absence of any ability for stakeholders to challenge the merits of final regulatory decisions fails to hold the regulator to account and contributes to making the current system unnecessarily adversarial. For these reasons we propose the withdrawal of the Competition Commission's current automatic advisory role within the price control system and its replacement with more transparent and robust appeal mechanisms. This would enhance the flexibility of the system by taking out the unnecessary and lengthy process of automatic referral of price controls to the Competition Commission and would enhance regulatory accountability as the regulator's decisions would be more open to challenge.

8.2. In addition to appeal mechanisms, we are proposing that the new regime incorporates the following additional measures to enhance accountability:

- Regulatory governance – in accordance with the recommendations of the Pilling review, the CAA's governance is being reformed to introduce a clearer board-level responsibility for regulator decisions. This will enhance transparency and facilitate better public and Parliamentary scrutiny of the CAA's performance (chapter 6 discussed steps that the DfT has taken to implement this change).

- Airport environmental reporting – we are sympathetic to the independent Expert Panel's proposal that Tier 1 and Tier 2 airports should be subject to an obligation to publish an annual report setting out: their environmental performance; what the likely environmental consequences of their Master Plans are; and, what further steps they intend to take to mitigate environmental damage.
Enhancing accountability

- Regulators’ Compliance Code – we are considering extending the Code to cover the CAA's economic functions. The Code aims to embed risk-based, proportionate and targeted approaches to regulatory enforcement.

These measures would supplement the CAA’s existing obligations to report annually to Parliament on its performance in pursuing its duties. This form of accountability would remain a key means of holding the CAA to account.

8.3. This chapter discusses the proposals with regard to appeal mechanisms before moving on to discuss the other proposals to improve accountability.

Mechanisms for appeal of CAA decisions

8.4. The appropriate role for the Competition Commission, the CAA decisions that should be subject to appeal, and which parties should have a right to appeal are issues that have attracted a range of views from stakeholders during the Review. Stakeholders were generally in favour of the Competition Commission becoming an appellate body in relation to airport regulation but views differed on which parties should be entitled to a merits-based review mechanism. In particular, airlines wanted the ability to appeal the CAA's decisions to the Competition Commission. BA noted that the Competition Commission has recommended that the right of appeal should be given to all parties “with a sufficient interest in the price cap”. BA was also of the view that the right of appeal should apply to all licence changes. Virgin Atlantic, easyJet and Ryanair were also strongly in favour of the airlines having a right of appeal.

8.5. There appears to be a broad consensus amongst stakeholders that the Competition Commission’s role for price control decisions, should change from providing advice before the CAA’s decision to being an appellate body for CAA decisions. There would appear to be broad support for this approach also to apply to other changes to licence conditions. In relation to the parties who are able to appeal, there also seems to be broad consensus that the affected licensee should have the right to trigger an appeal to the Competition Commission (even if this is formally done through rejecting a CAA proposal to change a licence condition, with the CAA making the actual reference to the Competition Commission). There is less agreement, however, about whether other parties, including airlines and consumer representatives, should have the right to trigger a Competition Commission review and, if so, which decisions this right should apply to. We note, for example, that the Expert Panel considers that the right to appeal for airlines and consumer 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 (which would set out how a price control, once set by the CAA, will be translated into the detail of charges).
8.6. This statement would make it clear which aspects of airport activities are covered by regulated charges and which were not, and, ahead of each price review, should explain how regulated charges are to be set. A statement should be prepared ahead of each price review, and the airport would have a duty to keep it under review. The Expert Panel suggests that the CAA should be required to approve such statements to ensure they reflect desirable principles, such as cost-reflectiveness and efficiency of provision. The CAA's decision to approve or reject the statement would then be subject to appeal on its merits by the licensee, airlines, and passenger representatives. This issue is related to that of the till because in the case of a single till, cross-subsidies from retail revenues have to be set against the costs of aeronautical activities. The airport’s statement would show how this was done.

8.7. We would like to propose a second way distinct from, but not necessarily exclusive of, the Panel’s proposal, that would provide other parties with some access to appeal the merits of CAA pricing decisions on licence modifications whilst not permitting merits-based challenges on every aspect of licence modification. This would be facilitated by obliging the CAA to publish a statement alongside its price control decision for Tier 1 airports. This would provide a principled explanation of the basis upon which the price control decision was reached. That statement would provide information on fundamentals of the price control methodology – including whether it is based on a RAB, and whether it is single or dual till. It would not, however, deal with the technical calculations and assumptions that were made beneath these fundamentals, such as assumptions around the licensee’s weighted average cost of capital (WACC). We recognise that it might be difficult to agree an appropriate level of detail that would be covered by such a statement of principles. For this reason it is likely to be necessary to specify in Legislation the minimum that would need to be covered in a statement.

8.8. Recognising the diversity of views on some of these issues, at this stage of the Review, we have decided to set out three broad options for the approach to appeals, within certain firm parameters, on which stakeholders’ views would be welcome. We propose that the Competition Appeals Tribunal should be the appellate body for CAA decisions regarding whether an airport has a Tier 1 licence and that broad access to a merits based appeal should be granted to all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators. The Competition Commission should be the appellate body for decisions on licence modifications and we propose that the licensee should be given the right to appeal the merits of CAA licence modification decisions, including those related to price control and service quality. The three options relate to the issues upon which parties other than the licensee should have a right to trigger an appeal to the Competition Commission on licence modification decisions. The options are:

87 Non-regulated charges would be subject to investigation by the CAA using its concurrent competition law powers.
• **Option 1** – Other parties with a material interest (including airlines, specified consumer groups and other airport operators) have equivalent rights of appeal to those granted to the licensee regarding CAA decisions to modify licenses. This would be broadly equivalent to the approach adopted in the telecoms sector.

• **Option 2** – 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, as discussed above, relating to how appeal rights could be extended beyond the licensee, upon which we would welcome stakeholders’ views. Two sub-options, which 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."
  - 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** – No right of appeal for other parties on CAA decisions to modify licenses. This would be consistent with the current approach in most other regulated sectors, except telecoms and for some energy codes. Under this option, other parties’ access to merit-based appeal would be limited to whether or not an airport should be subject to a Tier 1 licence.

8.9. We are clear 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.

8.10. We have set out below in more detail the considerations that have led us to set out these three options for consultation. We have also set out proposals for the process of appeals against licence condition changes irrespective of which parties have the right of appeal.

**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.

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This option has been proposed by the Review’s independent Expert Panel.
Reforming the framework for the economic regulation of UK airports

General principles

8.11. We have 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. Within a licence based system of regulation of airport services, the CAA would make many decisions including those of the following types:

- whether particular airports should be subject to the regulatory regime and, if so, to what extent. This applies particularly to decisions as to whether an airport operator should be subject to a Tier 1 licence;
- the control of prices and charges imposed by airports on airlines; and,
- the imposition, application, modification or withdrawal of licensing conditions.

8.12. The mechanisms for challenge are an important part of the design of any new framework for airport regulation. 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. 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 undermine the overall workability of the regulatory regime.

8.13. 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 remain available as a potential avenue of challenge for any party with sufficient interest in the outcome of the regulatory decision-making process, we are aware that the scope of an application for judicial review is limited. We have therefore considered whether it is appropriate for the new legislative framework to include specific mechanisms for challenging CAA decisions in addition to the rights of affected parties to apply for judicial review of those decisions.

8.14. In undertaking this analysis, we have recognised that there are certain fundamental principles that must be acknowledged in the design of any challenge mechanism. Unless these principles are acknowledged there is a risk that the mechanism will be viewed as deficient and inadequate to protect the interests of those who are affected by decisions. These principles include Article 6 of the European Convention of Human Rights (Schedule 1 of the Human Rights Act 1998) which provides for a fair trial in
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cases where an individual's civil rights are affected and gives rights to individuals, non-governmental organisations and groups of individuals. The principles of natural justice also underpin our system of law, and will apply. These principles mean that both individuals and bodies corporate must be treated in a manner that is consistent with basic principles of natural justice and the mechanisms for challenge should reflect this. We are also aware that the appeal mechanisms under any new regime will need to be designed to be compatible with the provisions of the Airport Charges Directive which will in due course be implemented into UK legislation.

8.15. We have been aware that the appropriateness of including specific provisions, and the nature of that provision, will depend to a large extent on the nature of the decision being taken. On the one hand, a decision may have far-reaching implications for the rights of both the party to whom it is addressed, and additionally for third parties who may have a legitimate interest. In such a case, the absence of any challenge procedure which allows for representations of both the party directly affected and third parties to be heard, might be a basis for a legal challenge to be made as to the fairness of the regulatory mechanism as a whole. On the other hand a decision may have limited effect on third parties and in those cases, recourse for others through the possibility of judicial review may be sufficient.

8.16. We now consider in turn the key decisions that the CAA would have to make under the new regulatory framework.

Whether an airport should be regulated under a Tier 1 licence

8.17. 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. It is arguable that it is right for a decision of this magnitude to be challengeable on its merits. The questions then arise as to who the appellate body should be, who should be the parties able to challenge, and what should be the scope of the challenge.

8.18. The options as regards the appropriate appellate body are the High Court, the Competition Commission, the Competition Appeal Tribunal (CAT), or the Secretary of State. Given the nature of the criteria upon which this decision would be based, the material of the case is likely to be competition based. Any appeal on its merits would essentially be an economic assessment including the assessment of market power held by an individual airport and any constraints on that power. The High Court would seem least well placed to deal with issues of this sort. Involving the Secretary of State would result in an outcome effectively similar to the current designation
system where the Secretary of State determines an airport’s status and would give the Secretary of State an important influence affecting investment at UK airports. The current designation system’s reliance on the Secretary of State to make final decisions on which airports should be subject to price control is not considered to be a positive feature. Bringing the Secretary of State into the regulatory system in this way adds additional uncertainty to the system which is inconsistent with incentivising good long-term investment outcomes. Referring any decision to the CAT would be more in line with the approaches taken in other sectors.

8.19. We consider that the outcome of the challenge should be determined on the economic, competition based merits of the CAA’s decision. For this reason we are of the view that the CAT would be the appropriate appellate body. 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. We also propose that the CAT should have discretion in relation to costs awards for both its own costs and those of any third party involved.

8.20. The decision whether to regulate an airport under a Tier 1 licence would affect the airport concerned, airlines operating at the airport, other businesses operating at the airport, certain other airports, consumers and possibly others. Allowing all of these parties the right to challenge the decision on its merits may lead to a challenge on each occasion the decision is made. This is not necessarily undesirable as the process would give all parties the opportunity for full participation in a key decision, and the timeframe for an appeal could be specified to occur within a reasonable but limited period, that is specified in legislation.

8.21. As set out above, we consider that the CAA’s decision about whether an airport has a Tier 1 licence should be subject to appeal to the CAT by all parties with a material interest, including the licensee, airlines, specified consumer groups and other airport operators. Providing access to these stakeholders to challenge this crucial decision would provide them with reassurance that airports will not be subjected to more rigorous regulatory control without good reason. This check on the regulator would also minimise the likelihood of disproportionate regulatory decisions by ensuring that the regulator makes informed decisions, and placing an onus on the regulator to be transparent with stakeholders regarding the basis upon which these decisions are made.

8.22. We are aware that granting broad access to appeal on this issue may result in every such decision being appealed by one stakeholder or other. This may not be a bad thing if these appeals have merit; however, it does create a risk of excessive challenge. To guard against this we believe it would be appropriate to build in provisions to deter frivolous or vexatious appeals. We would welcome stakeholders’ feedback on how such provision should be designed in this instance.

Consumer bodies would be specified in a list within Primary Legislation. The list could then be amended through a Secondary Legislation procedure.
8.23. Under the proposals set out in the previous chapter the CAA would also have discretion on whether or not to impose a Tier 3 licence on a small airport (servicing fewer than 5m passengers per year) where it had good cause to do so. This decision would have significant consequences for the airport operator in question as the licence may add to its regulatory burden. For this reason we propose that the CAA’s decision to introduce a Tier 3 licence should be subject to merits-based challenge from the airport operator to the CAT. We welcome feedback from stakeholders on the appropriateness of this proposed appeal mechanism.

The sunset clause

8.24. We propose that each Tier 1 airport should be evaluated against the criteria set out in paragraph 7.13 periodically by the CAA to assess whether the degree of scrutiny and control that these licenses will entail is necessary. A five yearly review may be appropriate as this is consistent with the provisions within the ACD and would provide an element of continuity with the current well understood quinquennial price control system. However, we wish to grant the independent regulator flexibility in the new regime that would allow the time period for a price control to vary as we believe this will be positive for providing appropriate investment incentives. For example, where an airport clearly has a high degree of dominance that is unlikely to diminish over a long period of say 10 years, it may be useful to set a longer-term price control if this would lower the cost of capital and incentivise the airport operator to pursue more ambitious investment plans that will add value for final consumers. For this reason we are minded not to set a specific time-frame for the formal periodic assessment of the status of Tier 1 airports. Instead we propose to specify that this assessment be taken at the end of each price control period. The CAA decision on this matter would be subject to appeal by all parties with a material interest (including the licensee, airlines, specified consumer groups and other airport operators) to the Competition Appeals Tribunal. This formal assessment would focus on whether or not a Tier 1 licence remains necessary at the airport in question, given its market position. We note that we expect that the CAA would in practice undertake activity to monitor the competitive pressures at airports regulated with a Tier 1 licence at more regular intervals within price control periods. We believe that this regular monitoring activity would satisfy the obligation within the ACD to assess competitive pressures regularly.

8.25. Were a Tier 1 licensee no longer to satisfy the criteria set out in paragraph 7.13, it would shift down to the less burdensome Tier 2 licence. This assessment would also examine the proportionality of each licence clause to ensure that no unnecessary burdens are placed on these airports.
8.26. These mechanisms would apply to each Tier 1 licence, and the provisions within them would therefore be effectively subject to a sunset clause requiring the CAA to review the relevance and appropriateness of a licence and its clauses. We consider that this approach is consistent with the Better Regulation principles because it helps to ensure that the regulatory arrangements are proportionate and targeted.

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?

The modification of licence conditions

8.27. We have set out above the provisions we propose for initiating and changing licence conditions, including those related to price control and service quality. This section considers how appeals might be handled in this process. Each of the water, gas, electricity, NATS and rail regulatory regimes contain detailed provisions for the modification of licence conditions and appeals against certain proposals. The procedures for the modification of licence conditions and appeals in these regimes have been considered by the DfT. The procedures have a number of standardised features which are summarised below. It is notable 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.

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90 It should be noted that there may be airports regulated under a Tier 1 licence who are not subject to price control conditions. It is the DfT's view that it should be for the CAA to decide if price control is required at an airport regulated under a Tier 1 licence. For the purposes of this discussion, we assume that price control conditions are imposed but the arguments also apply to a CAA decision not to apply price control conditions at a relevant airport.

91 Modification is defined as including additions, alterations and omissions - see for example section 219(1) Water Industry Act 1991.
8.28. Each 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.\footnote{See, for example, Section 17(5) Water Industry Act 1991.}

8.29. The regulator is typically able to seek to modify particular licenses 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 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.

8.30. Within this framework the regulator has no substantive right to modify licenses without agreement and it appears reasonable, where there is no agreement, for any decision to modify to rest with the Competition Commission. A key issue for the operation of a reformed regulatory system will be the extent to which rights of appeal on licence modification decisions are granted beyond the airport operator. The CAA considers that extending rights of appeal to airlines and other consumer groups would improve accountability but suggest that to do so risks every modification being appealed thereby making the system overwhelmed and slowed down by challenges. For these reasons the CAA do not favour an extension of access to merits based appeal rights on licence modification decisions to airlines. The Competition Commission in their current BAA Airports Market Investigation have taken a different stance. They suggest that limiting appeal rights to the licensee, the “traditional model”, might not be appropriate in this sector. To enhance regulatory accountability they have recommended that the right to challenge the merits of CAA decisions on licence modifications, such as the level of the price cap, should be extended beyond the licensee to other parties with a sufficient interest.
such as airlines. In taking this stance the Competition Commission cite examples of practice under the Communications Act 2003, and in the electricity and gas sectors where the “traditional model” has been replaced by a broader appeal mechanism.  

8.31. It is arguable that, because the decisions on price control and service quality are sufficiently important and so directly impact both airlines and consumers, 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 Expert Panel considers that all parties should only have a right to appeal an airport operator’s statement of charging principles (as explained above), with the price control itself subject only to appeal by the airport operator. The Panel believe that opening up merits 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.

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.  
  - 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?

Process for appeals

8.32. Irrespective of which parties have a right of appeal we have set out below a proposed approach for appeals to licence modification decisions:

• the process for licence modification should be set out in legislation and require the CAA to consult fully. The process should either explicitly require the regulator to engage in discussion with all parties affected (including the airport operator, airlines and passenger groups) or implicitly do so with a view to reaching agreement;

• 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[^95];

• 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 control 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;

[^95]: 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.
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- 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 control 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.

Environmental reporting

8.33. We are sympathetic to the Expert Panel’s proposal that all Tier 1 and Tier 2 airports should be subject to a licence condition requiring them to publish an annual report setting out their environmental performance, what the likely environmental consequences of their Master Plans are and what further steps they intend to make to mitigate environmental damage. These would be available for the scrutiny of the CAA, environmental regulators and other interested stakeholders. We are aware that a number of airports currently produce these reports as part of their overall corporate social responsibility strategy.

8.34. The purpose of this 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. Gaining local support and building trust over time is essential if an airport is to further develop and promote the interests of its passengers.

8.35. We propose that these reports would initially be subject to a publication obligation. However, it would be open to the CAA to seek to impose additional obligations by means of a change in licence conditions if it believed that such a change was necessary to enable it to better fulfil its duties.

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?
The Regulators’ Compliance Code

8.36. Last year, the Government issued the Regulators’ Compliance Code, which 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. Currently only the regulatory functions of the CAA relating to safety and consumer protection are covered by the Code as its economic functions are expressly excluded. The Government is considering extending the coverage of the code to include the CAA’s economic functions. This would place CAA under a statutory duty to have regard to the Code when exercising its economic functions as is currently the case in relation to its other regulatory functions.

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.

CAA annual report and accounts

8.37. After the end of each financial year, the CAA prepares an annual report of its activities, together with its audited accounts. The report outlines the CAA’s statutory duties and performance during the previous financial year and sets out in summary form the CAA’s forward plans. The report and accounts are laid before Parliament by the Secretary of State. This provides a basis upon which Parliament can hold the UK’s aviation regulator to account for its performance in pursuing its statutory duties."

Summary of key proposals

8.38. In this chapter we set out our key proposals with regard to ensuring appropriate accountability for the CAA’s decisions regarding economic regulation. We are particularly interested in receiving stakeholders’ views regarding which parties should have the right of appeal on particular decisions, and which designs should be subject to appeal with regard to setting price controls.

8.39. The next chapter discusses a number of the key issues for implementing effective regulation in the UK airports sector.

96 The CAA is audited by independent auditors appointed by the Secretary of State under section 15 of the Civil Aviation Act 1982 as amended by the Civil Aviation Act (Auditing of Accounts) Order 1984 (SI 1984/65).
9. Aligning airport services with passengers’ needs

Introduction

9.1. Within the framework of duties and powers for the CAA set out above, the CAA will have a range of decisions to make about the detailed approach to regulation. These include the form of price caps that should apply at airports with a Tier 1 licence, the best form of quality of service regulation to protect passengers’ interests and the circumstances in which separate owners of terminals at an airport might better meet passengers’ needs. Furthermore, the CAA will need to consider how best to fulfil its statutory duty ensuring that licence holders can finance their licensed activities.

9.2. Responses to the DfT’s submission to the Competition Commission in September 2008 generally believed that decisions about these detailed aspects of setting the price and service quality regulation should be left to the CAA to decide within the overall statutory framework. The DfT agrees with the stakeholders who expressed this view. The DfT considers that the CAA, within the context of appropriate checks and balances (such as the appeal mechanisms discussed in the previous section), is best placed to reach a view on a case-by-case basis of the form of price control and service quality regulation that should apply to each airport to best meet passengers’ interests. The main argument for determining approaches in advance would be the greater certainty this would provide for all stakeholders. However, given the uncertain nature of some developments in the future aviation sector, particularly if the Competition Commission’s proposals for divestment are implemented, we consider that the benefits of flexibility will outweigh the potential benefits of more certainty.

9.3. We have set out below some brief observations on a number of issues relating to setting the price and service quality regime, including:

- Ensuring users’ needs are adequately taken into account when setting the price control.
- The service quality regime.
- The approach to setting the price cap, including whether to use a single or dual till approach.
• Allowing the development of competing terminals.
• Proposals to ensure the financial resilience of airports to protect consumers’ interests.

9.4. It will in general be for the CAA to decide how best to address each of these issues. We have also set out in this section some views on approaches to helping ensure that airports can finance their licensed activities.

Aligning airports’ capital expenditure programmes with user needs

9.5. One of the key elements that the regulation of airports with substantial market power or dominance aims to achieve is to align the investment programme with the needs of consumers. In the absence of regulation these airports may tend to under-invest to hold down capacity thereby enabling them to capture additional profit from captive customers. To address this tendency, price regulation (such as RAB-based price controls) can be introduced in order to protect consumers from excess prices and to address the airport’s incentive to under-invest in order to constrain capacity. A perceived problem with investment programmes under price control (and especially RAB-based price controls) is that regulated airports lose their incentive to invest efficiently to meet consumers’ needs and are instead incentivised to “gold plate” investment to secure additional regulatory return. For airports subject to price controls the regulator must therefore take a pro-active role to influence investment programmes to ensure these are efficient and are well designed to meet consumers’ needs.

9.6. Direct regulatory intervention to appraise and, where appropriate, re-design every element of airports’ capital investment programmes may not be the most effective means of improving outcomes for consumers. It is not realistic to expect the regulator acting alone to be able to undertake the amount of analysis necessary to understand the commercial benefits and costs relating to each project in an airport investment programme or to be in a position to suggest or design alternative projects that might better meet passengers’ needs. For intervention at this level of detail the regulator can use a combination of effective consumer representatives (see the proposals in chapter 8) and the capacity of airlines – as highly incentivised and knowledgeable intermediate airport users – to provide scrutiny and discipline. In the current regulatory system the CAA have instigated a Constructive Engagement process as part of the price control process that aims to facilitate commercial negotiations between airlines and airports on the detail of capital expenditure to feed into the CAA’s final regulatory decision about the price control.

97 The Constructive Engagement process adopted by the CAA for the Q5 price cap review process seeks to encourage discussions between the airport subject to price cap and the airlines at the airport to reach as much agreement as possible about key aspects that affect the price cap including requirements for operating and capital expenditure. The CAA takes account of the outcomes of these discussions when making its proposals for the price cap.
We recognise that the introduction of the Constructive Engagement process has added value to the regulatory system at some of the airports by increasing the information available to the CAA when setting price caps, and better aligning the outputs delivered by the airport with the needs of its customers and consumers.

Therefore, we welcome the CAA's and the Competition Commission’s views that Constructive Engagement should continue to have a key role in setting price controls at airports. It has reduced the need for regulatory intervention at the micro level and has the potential to deliver more efficient investment outcomes that will improve outcomes for consumers. However, we note that the early experience of Constructive Engagement has frustrated some of the airlines (to varying degrees at the different airports) and the Competition Commission due to some difficulties in facilitating appropriate and timely flows of information between the participants. In addition, airlines have commented that there was a lack of clarity on how to proceed when there was clear disagreement between airlines and airports that could not be resolved. The CAA has already set out proposals for some changes to the process as part of its final proposals for the Stansted airport price cap from April 2009. We would expect it to consider the issues further in the light of the final report from the Competition Commission and comments in response to this consultation.

While it is primarily for the CAA to develop the detailed aspects of Constructive Engagement, in recognition of the views expressed by airlines and the Competition Commission we want to make sure that the new regulatory framework gives the CAA all the powers it could reasonably require to make Constructive Engagement work effectively. Therefore, we intend to give the regulator robust information gathering powers and the powers to distribute information to airlines where this will improve consumer outcomes. We believe this will allow the regulator to build on the successes of Constructive Engagement, enabling it to facilitate the process and to provide airlines with earlier and more complete information on airports’ investment programmes. Good quality information provision is the key to making the process work effectively.

In general we see it as positive for the regulator to take an active role in promoting dialogue between airlines and airport operators on the appropriate design of airport investment programmes. The regulator will continue to decide how the conclusions of the Constructive Engagement process are used to set the price cap. This will include deciding what course of action to pursue where there is disagreement between airlines and airport operators. The regulator’s approach to this role can take different forms, depending on the specific circumstances and the nature of the disagreements. Whatever approach the CAA adopts it will continue to be important that it explains clearly how it has taken account of the conclusions of the Constructive Engagement process when setting the price control. The final decisions the CAA takes in the process would be subject to appeal as part of appeals regarding price control decisions.
9.11. While an improved process of Constructive Engagement is likely to be very important in the new regulatory framework, we recognise that there will be circumstances in which the interests of passengers and airlines are not fully aligned. We agree with the Competition Commission that it is not sufficient for the CAA to conclude that the interests of airlines and passenger are not aligned for it to take an alternative view. The CAA needs also to be confident that any alternative view is based on evidence and analysis that provides a better view of passengers’ interests than the airlines. This is where the role of effective consumer representatives and direct surveys of consumers can be particularly important.

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?

Service quality regime

9.12. The CAA currently sets Service Quality Requirements (SQR) at Heathrow and Gatwick airports and will also do so for Stansted airport in the future. The CAA uses a public interest finding by the Competition Commission as the mechanism for setting SQRs. There is broad industry and stakeholder support for the CAA setting minimum standards for service quality at airports that have substantial market power or dominance. However, a number of issues have been raised about their detail in responses to the Call for Evidence and during discussions, which are explored further below.

9.13. Currently, SQRs focus on activities that are controlled by the airport operator only. However, feedback from focus groups and surveys is that the experience of passengers at the airport is part of a wider end-to-end journey determined by the activities of many agents, and that the experience at the airport is determined by a range of different organisations. As highlighted in the DfT’s work on ‘Improving the Passenger Experience’ published last year, Government and airlines, as well as surface access providers, are responsible for the passenger experience as well as the airport operator. For example, there is a lot of information that suggests passengers wish to avoid spending time queuing at check-in, immigration and security. Therefore, it seems sensible to consider whether the SQRs ought to be extended to those parts of the passenger experience in the airport that is controlled by parties other than the airport operator, since it would provide a better fit between the scope of the SQRs and the passenger experience.

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9.14. In this regard, we note that the UK Borders Agency (UKBA) has recently taken forward a series of initiatives to improve the passenger experience. UKBA have developed Service Level Agreements with major airport operators to provide streamlined communications with Border Force managers and to provide public commitments on queuing times for passengers. In August 2008, automated clearance barriers were trialed at Manchester Airport, followed in December 2008 by a further trial at Stansted airport. Adult British and European Economic Area (EEA) citizens who hold biometric e-Passports can use the barriers. This provides efficient self-service clearance systems at entry points to process low-risk passengers more quickly, and free up staff to deal with more challenging passengers. The UK Borders Agency aims to have rolled out similar technology to ten UK airports by the end of August 2009. We also note that the Competition Commission felt it would be ‘unlikely to be appropriate’ for SQRs to be imposed on airlines, given that they operate in a generally competitive market. A possible alternative approach, on which we seek views, may be for the airport to have some targets that better reflect a passengers’ entire end-to-end journey and are more holistic in nature, e.g. measuring overall passenger satisfaction, which it could then use as the basis for contractual obligations between the airport, and airlines that affect the passengers’ experience. Such an approach would be intended to encourage the airport and airlines to see the passenger experience as a shared responsibility.

Q9.2 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?

9.15. A number of criticisms have been made of the way that service quality is measured by the current SQR regime, including the metrics themselves as well as the method of monitoring them (more details can be found at the links above to the relevant CAA documents). Some of the metrics seem to be one step removed from the outcome that determines the passenger experience, although we note that the performance of some airport services whilst not directly visible to air passengers are critical to a good passenger experience. While some of the metrics used are likely to reflect practical issues or difficulties in capturing relevant data, there are some areas for which it might be worth considering if the metric could be improved by using a more direct measure of the passenger experience. For example, one of the metrics used under the current SQR scheme is the percentage of time passenger service equipment (lifts, escalators and travelators) is available. This measure does not reflect the percentage of passengers affected by faulty machinery and provides no incentive for the airport operator to service the equipment at times to minimise the inconvenience to passengers, such as late at night. The more flexible powers for the CAA to develop price and service quality regulation at Tier 1 airports should help to facilitate more targeted and appropriate service quality regimes.
9.16. The monitoring of the SQRs is currently carried out by BAA and there has been some controversy over whether the reporting is accurate and/or meaningful. For example, the Competition Commission raised concerns about the discrepancy between the results of BAA passenger surveys and the international benchmarking of its airports and so recommended an independent annual audit of the design and methodology for generating the metrics used for the SQR scheme.”

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?

9.17. The incentives for BAA to meet (and better) the SQRs is provided by a rebate (and bonus) scheme to (and from) airlines. It has been suggested that the potential size of the rebate (or bonus) is not large enough to adequately incentivise airport operators to improve the quality of service offered. Indeed, a number of airlines have gone further and commented that the rebates do not cover the costs incurred by them when the service standards are not met. Other stakeholders have felt that the bonus element of the scheme was not appropriate. The Competition Commission argued that the bonus scheme was unwarranted since BAA would gain in other ways if the SQRs were met. Airlines suggested that it exacerbated the tendency to ‘gold-plate’ created by RAB based regulation. It has also been suggested that the airlines are an indirect consumer of the service quality at the airport and the incentive payouts ought to be given directly to the passengers. However, providing rebates and bonuses to the passengers directly might pose a number of administrative or practical difficulties and we note that if airlines are operating in a competitive market the rebates and bonuses would be passed onto consumers via changes to air fares.

9.18. More flexible powers for the CAA should help to ensure that the financial incentives relating to the service quality regime are well targeted and proportionate. Stronger information gathering powers for the CAA may also allow it to understand better the potential costs and benefits of achieving different levels of performance. In addition, the regime to encourage investment in capacity and the potential that the licence has to influence runway utilisation (see para 7.20) has the potential to improve service quality, for example through the reduction in delay. We would welcome stakeholder feedback on the proposed package of reforms in terms of its ability to improve passenger outcomes.

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?

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Provision of service quality information to passengers

9.19. We considered whether all airport operators should be required to publish information on service quality with the aim of enabling passengers to make more informed choices. However, as we argue in chapter 4, given the ambiguous evidence about how much passengers would value this information, it is not clear that there is a compelling economic rationale for placing this requirement on all airports. It would only be appropriate to require all airports to collect and publish the information if the costs of doing so were very low, and therefore likely to be less than the potential benefits. However, at this stage we have not seen evidence that this would be the case.

Co-ordinating role in the provision of airport services

9.20. As discussed in chapter 4, the through-airport experience involves a range of different organisations that need to co-ordinate the provision of their services to ensure that passengers receive a good quality of service. Where airports have substantial market power, or dominance, airports may lack the incentive to devote sufficient resources to ensure that this occurs. A primary duty to promote the interests of consumers provides the economic regulator with a statutory remit to intervene to improve co-ordination between the different parties operating at an airport to improve the passenger experience. It will be for the CAA to decide how this is best achieved, and in particular to consider whether any steps it takes are likely to improve the passenger experience without leading to significant unintended consequences. We note the CAA has recently taken steps to address this issue at Heathrow, Gatwick and Stansted airports.

Approach to setting price caps

9.21. It is clear from the ongoing considerations for the new Stansted price cap and the responses to the DfT’s submissions that there are a range of views amongst stakeholders about the appropriate form of price cap. This suggests that it will be important for the CAA to carefully consider under the new regime the approach to setting price caps. The Competition Commission in its recent report on the Stansted price cap review, BAA and others have strongly supported the retention of RAB based regulation. The CAA and some airlines have advocated consideration of other approaches given their concerns about the distortions that can be caused by RAB based regulation and their view of the competitive pressures that Stansted airport is facing and will face in the future.

9.22. RAB based regulation is well established within economic regulation and the UK airports sector, and therefore well understood by investors (this is confirmed from discussions we have had with investors). The properties and understanding of RAB can help to provide a strong environment for investment. However, there may be circumstances, particularly if the
Aligning airport services with passengers’ needs

Competition Commission implements its divestment proposals and there is a substantial capacity expansion, when other forms of price regulation may be more appropriate for one or more of the price capped airports, because of increased competitive pressures. Such alternatives could be a prelude to ending price cap regulation for some airports. The potential for this change in circumstances increases the importance of giving the CAA flexibility to decide the most appropriate approach to price control in each case. However, given the well established nature of RAB based regulation it will be important that the CAA works with stakeholders and investors to develop and explain well ahead of time any proposals to adopt alternative forms of price cap regulation.

9.23. A number of respondents to the DfT’s Call for Evidence and submission to the Competition Commission have commented on detailed aspects of the implementation of RAB based regulation. Some of these issues have also been raised in the Competition Commission’s Market Investigation.

9.24. However, other stakeholders acknowledged that the specifics of the regulatory regime will largely be decisions to be made by the regulator. The CAA, MAG and BA all thought that the review should concentrate on matters other than the specific regulatory methodology. The DfT agrees that these are matters for the CAA to consider, and we would expect that the CAA will carefully consider all the points raised as part of continuing to develop its approach to setting price controls under a new regulatory framework.

The single and dual till approaches to airport charges

9.25. Currently, the decision about whether to use a dual till or single till approach to setting airport charges is made by the CAA as part of its decision about setting the level of airport charges. In line with the conclusions of the Expert Panel and a number of stakeholders, we envisage that this approach will continue under the new regulatory framework. The best approach to setting airport charges will depend on the competitive conditions at an airport and on factors such as the existing capacity of that airport. This suggests that there are benefits to having a flexible approach that allows the regulator to decide which till to use on a case by case basis, rather than setting the choice of till in the statutory framework.

9.26. A number of stakeholder responses to the DfT’s submission to the Competition Commission on provisional remedies felt that the specifics of the regulatory framework, including the single and dual till debate should be left to the discretion of the regulator. For example, the CAA considered that the DfT did not need to comment on these issues and Manchester Airports Group was of the view that the choice of methodology was a matter for the regulator.
9.27. The single or dual till debate is about how to set airport charges for aeronautical services. Where the price cap at an airport is regulated using the single till approach, the airport’s revenue requirement (that is, the amount required from airport charges to cover the cost of aeronautical services) is reduced by the commercial revenues that the airport is expected to earn. Under the dual till approach the airport’s aeronautical and commercial activities would be separated, with revenues and specified costs being allocated to the aeronautical and commercial tills. The price cap to be set for aeronautical activities would be set on the basis of the aeronautical till only.

9.28. The single till approach is the traditional method for setting airport charges and is the approach currently applied in the UK. However, the issue has been the subject of some debate, with the relevant regulators, the CAA and the Competition Commission, engaging in a wide-ranging discussion between 2000 and 2003 in the context of the airport quinquennial reviews. The CAA issued a consultation paper in 2000 noting the problems of the single till approach and suggesting further work on the practical implementation of the dual till approach. The Competition Commission considered the CAA’s proposals regarding the single till and dual till approaches and, in 2002, issued a statement which concluded that it was proposing to exclude the dual till approach from that particular price control (although it did not rule out reconsidering such an approach in the future).

9.29. The issue now seems to be more settled amongst the regulators with the Competition Commission recommending in the recent Stansted Q5 review that airport charges at Stansted should continue to be set on a single till basis. This follows a similar conclusion for the Heathrow and Gatwick Q5 price cap reviews. These decisions were partly made on the basis that most parties had suggested that the single till approach should continue to be used.

Developing and operating competing terminals

9.30. In 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 allow the possibility of separating the operation and development of terminals, where investments are incremental, from runways that are characterized by lumpy investments. Only the separation of operation and development of facilities should be allowed, with planning decisions remaining with the airport operator. The current regulatory framework does not clearly permit such an approach. The Competition Commission’s Provisional Decision about Remedies supports allowing separate ownership of terminals.

9.31. This approach has a range of advantages. Firstly, it might represent one way of delivering more timely and appropriate investments. Secondly, it would allow airlines to tailor the services offered at the terminals to their needs and would 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.

9.32. This approach to regulation also has some risks. Firstly, effective inter-terminal competition may not arise. Secondly, allowing airlines to become terminal providers has the potential for exclusionary behaviour. Thirdly, given that airports are an integrated system, the separation of terminals and runways may introduce co-ordination challenges, especially since there is no clear break in responsibilities and costs.

9.33. Inter-terminal competition has been introduced in a number of countries, but we recognise that the circumstances leading to its introduction are often different from those that currently apply in the UK aviation sector. Therefore, we do not want to mandate its use or to prescribe too tightly how it would be introduced, but instead to introduce a regulatory framework that permits its introduction where the CAA considers that it will further passengers’ interests.

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.

Promoting financial resilience

9.34. The DfT proposes that the new regime will introduce measures that will strengthen the financial resilience of airports. This will include measures to ensure that the new regime is clearly consistent with airports subject to price control being able to efficiently finance their businesses. Amongst the key measures to help achieve this are the new duty on the CAA to ensure that airports can finance their licensed activities, proposals for a licence condition to introduce financial ring fencing\(^\text{\ref{fn:ringfencing}}\), proposals for a credit rating test, and proposals for a Special Administration regime, which will also help to protect consumers in the event that an airport faces financial failure. Any proposals set out in this section are intended for use only on Tier 1 airports and the detailed implementation and enforcement of these would be a matter for the regulator.

9.35. We understand that measures proposed in this context may have an impact on airports’ existing financing arrangements. For example, BAA’s current financing arrangements are based on an approach to security which differs in some respects from that implied by the ring fencing and special administration regimes set out in other industries. At this stage we are keen to consult with stakeholders to understand the full costs and benefits of the

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\(^{\text{\ref{fn:ringfencing}}}\) 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.
range of proposals we are considering. In addition we are looking to get feedback on how these proposals might be designed and implemented in order to achieve the best outcomes for consumers. This means that measures should only be introduced when market conditions allow this to be achieved efficiently. Were any of these measures to be introduced we would expect that the regulator would work with regulated businesses in accordance with its statutory duties to manage the transition process in order to minimise any disruption to existing financial structures. We consider that introducing the full package of measures together would be likely to provide the greatest protection to consumers, but it may also be appropriate to introduce limited parts of the measures if that minimises any disruption to existing financial structures.

**Special Administration**

9.36. Special Administration regimes exist for a number of regulated industries operating essential infrastructure networks. These include railways, water, energy and the London Underground public-private partnerships. Moreover, closest to airports, there is a Special Administration regime for air traffic services under the Transport Act 2000. The main purposes 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 to the UK economy – there is provision to ensure this airport will continue to operate in the event of it failing financially.

9.37. The objectives of the Special Administration regime are normally to manage the company’s affairs, business and property in a manner which protects the interests of the company’s members and creditors with the aim to ensure the continuity of the licensed activities. The difference between a Special Administration regime and the general insolvency regime under the Insolvency Act 1986 is that the Special Administrator has additional duties to ensure the continuity of the regulated business and, so far as necessary, transfer the licensed activities to another company, which is capable of fulfilling the functions specified. The Special Administration regime gives the regulator and the Secretary of State a degree of control as to the outcome of the insolvency process of a regulated business to ensure that the interests of consumers are protected by safeguarding the ongoing provision of essential airport services in a manner which protects the interests of the company’s members and creditors. In contrast, under the insolvency legislation it would be possible for an administrative receiver to cease trading, take possession of the secured assets of the company and sell such assets (e.g. sell the land for housing). Similarly, an administrator under the insolvency legislation may, subject to certain conditions, realise the assets in order to make a distribution to one or more creditors. In any event, the primary duty of an administrative receiver is to the secured creditor(s) who appointed him and an administrator must perform his functions in the interests of the company’s creditors as a whole – the duty of an administrative receiver or an administrator does not involve the protection of the interests of the consumers or ensuring the effective operation of the UK economy.
9.38. There is some argument about the impact that the existence of a Special Administration regime has on the cost of capital and on operators’ ability to raise the amount of capital they need. On the one hand it is suggested that it raises the cost of capital as it risks outside interference with the security that existing lenders have over an airport’s assets. In the case of airports, where the risks associated with passenger volumes mean that returns are not as stable as in other regulated industries, it is argued that this security is more important for investors.

9.39. However, it can also be argued that the existence of the option of Special Administration as part of a wider package of measures to ensure financial resilience can provide a powerful incentive on management to maintain the quality of service and to be prudent financially. Although it is difficult to isolate the impact of individual factors, the experience of other regulated sectors suggests that a regime including Special Administration, combined with a financing duty on the regulator and measures to ensure the licensee has adequate funds, is regarded by investors as credit positive. The roles of the licensee to carry out its functions effectively and of the regulator to ensure the licensee has sufficient revenue to cover the operations of the business and the capital expenditure would be clearer. This can provide a more robust long-term framework for planning investment in the sector thereby reducing perceived riskiness. In addition, the duty of the regulator to ensure that the licensee has sufficient funds to finance the activities, which are the subject of the relevant licence obligations, as well as the proposal to impose the requirement to maintain an investment-grade credit rating on Tier 1 airports will enhance the overall financial resilience of the business.

9.40. The CAA’s provisional view was that a Special Administration regime was unlikely to be justified for UK airports. The CAA set out two main potential justifications for the introduction of a Special Administration regime:

- where government is a significant provider of funding and, in effect, guarantees the financial position of the company; or
- where even short-term operational interruptions would result in significant costs to the wider economy or where public safety would be put at significant risk by even a short interruption to supply.

The CAA did not feel that these points could be strongly argued in the case of airports.

9.41. On balance, we take the view that the potential negative impacts of the financial failure of a large airport – in particular Heathrow – would be sufficiently large to warrant the introduction of Special Administration providing implementation costs are not excessive. 186,000 passengers fly from Heathrow airport every day, meaning that a financial failure that resulted in 1 week of non-operation will prevent more than 1 million passenger movements. This would be potentially very damaging for those involved as trips would have to be cancelled and business meetings missed. It is not realistic to expect that other airports would be in a position to effectively meet such demand. Against this there will be some transitional issues, in particular relating to BAA’s existing financing, to address but these will depend in part on the detailed nature of the new proposals. We would welcome comments and evidence on these issues.
Ring fencing and other licence conditions

9.42. Ring fencing means that the licensee is limited in the circumstances in which it can take cash out of the regulated business, diversify into potentially loss making businesses, make disposals or create (or permit to subsist) security interests over its assets if to do so will put the business at risk of failing to be able to finance its functions. These provisions are generally accompanied by other provisions to help assure the regulator that the company has sufficient resources to meet the needs of the regulated business. These are similar to provisions often required by lenders. It should be noted however that ring fencing for regulated UK utilities generally allows companies discretion to pass up cash by way of dividends as long as their financial profile is above a certain threshold. Hence the need for regulators to make additional modifications relating to ‘lock up’ of cash in certain circumstances – for example, in the case of a change of control.

9.43. In other licensed regulated industries, as part of the package of measures to ensure the financial resilience of regulated companies, it is common for operators to be subject to a requirement to maintain an investment grade credit rating above a specified minimum. There are different approaches possible to introduce such a provision, for example one could introduce a range or a specific rating, relating to the company or the debt. Overall, however, it is a useful way for the regulator to monitor and reassure itself that the financial and overall performance of the regulated airport is strong and may act as an early warning sign which gives the regulator, the company and its creditors the opportunity to deal with any financial difficulties in time without triggering the need for Special Administration. The advantages of such a provision requiring the operators to maintain an investment grade credit rating are considered to be that it will discourage excessive gearing and the consequent risk to financial stability and, where necessary, encourage equity injections to enable investment. Against this, it is argued that regulators should concentrate on outputs and service quality and that it places undue reliance on rating agencies, which can in turn put pressure on a regulator to make a more generous settlement rather than risk triggering a breach. We would welcome views that suggested any alternative approach to the use of credit rating agencies to provide similar re-assurance.

9.44. Our provisional view is that ring fencing licence conditions and a requirement to maintain a certain credit rating could play a useful role in the new regulatory system to encourage financial resilience and protect consumers from financial failures. It will ultimately be for the regulator to decide how such conditions would be introduced into licenses, subject to an appropriate appeal mechanism (as discussed in chapter 8).
9.45. We consider that the measures referred to in this section would not extend beyond the regulated business and will apply only to Tier 1 airports. As noted above, where companies are economically regulated there will be reciprocity between the obligation to deliver the service and ensure that the company maintains the resources to do so, and the obligation of the regulator to ensure financing.

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?

Conclusions

9.46. This chapter discusses a range of detailed aspects of price and service quality regulation, including financial resilience that the CAA will need to address in a new regulatory framework, particularly with regard to the regulation of Tier 1 airports. Within the new regulatory framework we are proposing that decisions about how best to address these issues are left to the CAA on a case by case basis. Therefore, in this section we are seeking views about how best to facilitate that within the regulatory framework and highlighting some of the issues raised by stakeholders during this Review.

9.47. The final chapter seeks views on proposals to enhance consumer representation in the UK airport sector, which should increase the focus on improving the passenger experience.
10. Enhancing consumer representation within the aviation sector

Introduction

10.1. The proposed reforms to the economic regulatory regime for airports, 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. For these reforms to be effective and to deliver the improvements to the passengers’ experience demanded by passengers they must be supported by effective channels of consumer representation within the sector.

10.2. We have therefore reviewed existing institutional arrangements for consumer representation within the sector to ensure that appropriate arrangements are in place to further develop the CAA into a leading consumer-focused regulator. This will, amongst other things, require arrangements for a powerful and independent consumer input into both economic regulation and wider consumer policy matters.

10.3. In the remaining sections of this chapter we:

- Discuss the through airport experience from the perspective of passengers.
- Explain the current arrangements for consumer representation in the UK aviation sector.
- Explain recent developments in the CAA's approach to consumer representation.
- Set out our proposals for enhanced consumer representation in the UK aviation sector.
Through-airport experience from the perspective of passengers

10.4. Our starting point was to consider the through-airport experience from the perspective of passengers. It is clear that the customers of airports and airlines are one and the same, although we note that the passenger has a contract with the airline (through purchasing an airline ticket) with airlines purchasing airport services on behalf of the passenger. In our view, this further reinforces the need for an independent voice for the passenger in relation to airport services. The research findings from the air passenger focus groups (discussed in chapter 4) supported the DfT’s end-to-end journey approach to transport links, with most passengers viewing 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, and that usually the actual experience was better than expected, when problems did arise there appears to be no focal point with overall responsibility to resolve complaints effectively.

10.5. In summary, arrangements to represent the interests of consumers would ideally cover both airline and airport issues and, as far as is possible, each stage of the end-to-end journey.

Existing arrangements for independent consumer representation

10.6. Under existing arrangements, the Air Transport Users Council (AUC) represents the interests of users of air transport at the national level. 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 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 EU Regulation enhancing the legal rights of air passengers, in particular with regards to denied boarding, cancellation and delays. Indeed the AUC has played a leading role both in Europe and the UK undertaking this function.¹⁰⁴ 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

¹⁰⁴ The CAA was designated as the National Enforcement Body under EC Regulation 261/2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delays to flights. The AUC was designated as the complaints handling body for the purposes of the Regulation.
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.  

10.7. In relation to airports, Airport Consultative Committees would appear to be the only bodies where the interests of passengers are represented, although it must be noted that the main focus of these groups are on local community issues, with little passenger input except at the largest airports which have passenger service sub-committees.

Recent developments in consumer policy within the CAA

10.8. The CAA has recently taken steps to further develop its consumer policy role. In addition to the air passenger survey undertaken in 2008 and its assessment of co-ordination between different airport service providers undertaken in response to advice requested by the Secretary of State for Transport (under s.16 of the Civil Aviation Act 1982) on how to improve the through-airport experience (discussed in chapter 4), the CAA has recently proposed a number of initiatives to strengthen its consumer policy function and consumer representation in air travel. These proposals were the result of an internal review and built on recommendations that came out of the Pilling report on consumer policy and the future of the AUC. The main proposals include:

- CAA to co-ordinate its activities with other regulators, in particular the OFT, to develop a more systematic approach to taking account of consumers across the CAA's regulatory roles, on the lines of the OFCOM 'consumer toolkit'
- Working more actively with airlines to improve standards of customer care in handling complaints;
- the CAA should expand its regulatory toolkit beyond criminal sanctions to include civil proceedings, e.g. for airline pricing practices under the EU Third Aviation Package and as a proportionate means of enforcing the EC regulation on denied boarding and cancellation;
- publishing guidance to industry on consumer legislation applicable in air travel and its enforcement procedures to increase the transparency and accountability of the CAA's approach to consumer policy and protection;
- where the CAA has evidence that co-ordination difficulties between service providers at airports are impairing service to passengers the CAA will consider serving as a catalyst in the short-term to promote co-ordination.
- the air travel consumer representation body should work with passenger services subcommittees at major UK airports; and

105 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).
• the consumer representation body should have an appropriate mix of skills and be resourced to support the CAA's developing consumer policy role including carrying out research on key passenger issues in the market to influence the CAA's work and Government. CAA and the consumer representation body should have a Memorandum of Understanding including the principles set out in the joint BERR/HMT report “Benchmarking the performance of the UK framework supporting consumer empowerment”.

Reforming consumer representation within the aviation sector

10.9. Drawing on experience in other sectors and having regard to the particular needs of air passengers – as both users of airports and airlines – and the existing arrangements in place to represent their interests in the wider end-to-end journey, we have considered options in the context of reforms to the economic regulation of airports for the appropriate structure of consumer representation. We first set out the different functions of the reformed arrangements, before considering options for the appropriate bodies for undertaking these functions.

10.10. The proposed approach follows closely that advised by the Review’s Expert Panel.

Principles of consumer representation

10.11. We propose that the institutional arrangements for measures to improve the passenger experience should reflect the following principles:

• There should be an independent policy advocacy function, which has authority and credibility with government, the CAA, the industry and the public. This should be sufficiently well-resourced to allow it to develop sector-specific expertise and underpin its analysis with insight into the needs, aspirations and experiences of passengers. 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 consumer input to regulatory strategies and decisions. Given the connection between economic regulation and service quality issues, and the difficulty for passengers in determining who is responsible for which service, this should cover both airport and airline related issues.

• 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.
10.12. These reforms complement the measures outlined above giving airlines a more central role in the economic regulatory process. Airlines have a key role to play, particularly given their specialist knowledge in a number of areas which, whilst not directly visible to the passenger, are likely to have significant effects on passengers’ airport experience.

Independent body to represent the interests of air passengers

10.13. 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, we propose that Passenger Focus should be given responsibility for air passenger representation with regards to airline and airport issues. Currently Passenger Focus carries out passenger representation for Great Britain’s National Rail passengers. Soon Passenger Focus will start to represent bus, coach and possibly light rail passengers in England, outside of London. The Secretary of State would ensure that appointments to the board of Passenger Focus would include appropriate knowledge of the air travel market. This approach further builds on the Pilling Report’s principle of a statutory body separate from the regulator, but better reflects the needs of air passengers – as customers of both airlines and airports – and the role of airports within a wider integrated transport system. We are aware that some users of airports will use modes of public transport outside Passenger Focus’ remit. There are other statutory consumer bodies representing these passengers and we would welcome views on how we can maximise the end-to-end approach to airport journeys, without duplicating effort.

10.14. We are interested to explore further 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. The CAA has also identified the potential benefits of this approach to advocacy as demonstrated by their recommendations to the Secretary of State following their internal review of their consumer policy function (discussed above). In particular, we would welcome views on the suggested role of Passenger Focus in developing and supporting a network of consumer panels at leading airports and the appropriate form that these panels should take.

10.15. We propose that Passenger Focus’ air passenger representation functions would be industry-funded via the licence fee for administering airports 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. In 2007, this cost would have been spread between more than 240 million passengers.106 This funding arrangement would replace the current funding arrangements for the AUC, for which industry indirectly pays via the CAA. The advantage with funding air passenger representation via the licence fee is that it would be the users of the air transport services who would pay. This would include passengers on both domestic and foreign carriers using

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106 See Figure 3.1. We envisage that enhancing consumer representation within the sector will cost no more than a few pence per passenger per year.
UK airports. We believe that this would represent a fairer funding arrangement than if the body was funded through general taxation since those who receive the benefits of improved consumer advocacy would pay and those who do not fly would not. We note that internal arrangements would need to be in place to prevent cross-subsidy where there were a number of different funding streams for different transport modes, particularly where these are funded through general taxation, although we see some advantages from an element of shared-funding given the end-to-end focus such a body would promote.

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.

Complaint handling

10.16. We propose that Passenger Focus would also mediate complaints where the passenger and service provider have been unable to reach agreement. This would include taking on legal responsibility from the AUC for complaints handling with regard to some EU passenger law. There are a number of advantages to this. Firstly, from the perspective of the passenger, Passenger Focus would provide a one-stop shop for improving transport complaint handling systems. Secondly, 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 giving responsibility for both complaints and advocacy to the same body. This advantage was acknowledged by both the Pilling report and the CAA. It also minimises 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 law and consider this would be best achieved by integrating the AUC within Passenger Focus.

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?
Reforming the framework for the economic regulation of UK airports

Consumer perspectives within the regulator

10.17. We discussed above that the CAA – in its internal review of its consumer policy – has identified a need to ensure that all its policies address the passenger interest. We propose to build on this progress, with the aim of further developing the CAA into a consumer-focused regulator which clearly demonstrates that it is underpinning its approach and decisions with insight into the experiences and needs of air passengers. The creation of a powerful and independent consumer input into both economic regulation and wider consumer policy matters will help. This will need to be supported by an on-going programme of consumer engagement and research, and engagement with relevant organisations. We note that other economic regulators 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. This could be done informally, through an enhanced role for the Consumer Protection Group within the CAA, or created by statute. Whether this approach is adopted or not is a matter for the CAA to consider further. We note that the Expert Panel see 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. We propose similar funding arrangements to those discussed above in relation to policy advocacy.

Summary of key proposals

10.18. To ensure effective consumer representation in the UK aviation sector we are proposing to give Passenger Focus a range of additional responsibilities, focused principally on policy advocacy and complaints handling for the UK aviation sector. We also welcome the CAA’s increased focus on its consumer policy function and the proposed changes to the way it will fulfil this role. Together these proposals and changes have the potential to significantly enhance the voice of passengers in influencing the development of regulatory policy.
1.1. The Government has adopted a Code of Practice on consultations. The Code sets out the approach Government will take to running a formal, written public consultation exercise. While most UK Departments and Agencies have adopted the Code, it does not have legal force, and cannot prevail over statutory or other mandatory external requirements (e.g. under European Community Law).

1.2. The Code contains seven criteria. They should be reproduced in all consultation documents. Deviation from the code will at times be unavoidable, but the Government aims to explain the reasons for deviations and what measures will be used to make the exercise as effective as possible in the circumstances.

The Seven Consultation Criteria

1. **When to consult:** Formal consultation should take place at a stage when there is scope to influence the policy outcome.

2. **Duration of consultation exercises:** Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. **Clarity of scope and impact:** Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

4. **Accessibility of consultation exercises:** Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. **The burden of consultation:** Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees’ buy-in to the process is to be obtained.

6. **Responsiveness of consultation exercises:** Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. **Capacity to consult:** Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

1.3. A full version of the code of practice is available on the Better Regulation Executive website at:


1.4. If you consider that this consultation does not comply with the criteria or have comments about the consultation process please contact:

Lec Napal  
Consultation Co-ordinator  
Department for Transport  
Zone 1/33 Great Minster House  
76 Marsham Street  
London, SW1P 4DR  
email: consultation@dt.fs.gov.uk
### Annex 2 – List of consultees

<table>
<thead>
<tr>
<th>Aberdeen Airport Consultative Committee</th>
<th>Cardiff Airport Limited</th>
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<tbody>
<tr>
<td>Air Transport Users Council</td>
<td>Cardiff International Airport Consultative Committee</td>
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<tr>
<td>Airport Operators Association</td>
<td>Chartered Institute of Logistics and Transport (CILT)</td>
</tr>
<tr>
<td>Association of British Insurers (ABI)</td>
<td>City of London Corporation</td>
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<tr>
<td>Aviation Environmental Federation</td>
<td>Civil Aviation Authority (CAA)</td>
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<tr>
<td>BAA Airports Limited</td>
<td>Commission for Integrated Transport (CfIT)</td>
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<tr>
<td>Belfast City Airport Forum</td>
<td>Competition Commission (CC)</td>
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<tr>
<td>Belfast International Airport Limited</td>
<td>Confederation of British Industry (CBI)</td>
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<tr>
<td>Birmingham International Airport</td>
<td>Consumer Focus</td>
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<tr>
<td>Consultative Committee</td>
<td>Department for Business, Enterprise and Regulatory Reform (BERR)</td>
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<tr>
<td>Birmingham International Airport Limited</td>
<td>Department for Environment, Food and Rural Affairs (Defra)</td>
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<td>bmi</td>
<td>Department of Energy and Climate Change (DECC)</td>
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<td>Board of Airline Representatives in the UK Limited (BAR UK)</td>
<td>Disabled Persons Transport Advisory Committee (DPTAC)</td>
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<tr>
<td>Bournemouth Airport</td>
<td>Durham Tees Valley Airport Consultative Committee</td>
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<tr>
<td>Bristol International Airport Consultative Committee</td>
<td>East Midlands Airport Independent Consultative Committee</td>
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<tr>
<td>British Air Transport Association (BATA)</td>
<td>easyJet</td>
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<tr>
<td>British Airways (BA)</td>
<td>Edinburgh Airport Consultative Committee</td>
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<tr>
<td>British Business and General Aviation (BBGA)</td>
<td>Environment Agency</td>
</tr>
<tr>
<td>British Chamber of Commerce</td>
<td>European Low Fares Airline Association</td>
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</table>
FedEx
Freight Transport Association
Friends of the Earth
Gatwick Airport Consultative Committee
Glasgow Airport Consultative Committee
Glasgow Prestwick Airport Limited
Glasgow Prestwick International Airport Consultative Committee
Greenpeace
Heathrow Airport Consultative Committee
Her Majesty’s Treasury (HMT)
Highlands and Islands Enterprise
Home Office
International Air Transport Association (IATA)
Inverness Airport Consultative Committee
Leeds Bradford Airport Consultative Committee
Leeds Bradford International Airport Limited
Liaison Group of UK Airport Consultative Committees
Liverpool John Lennon Airport Consultative Committee
Local Authorities Coordinators of Regulatory Services (LACORS)
Local Government Association (LGA)
London City Airport Consultative Committee
London City Airport Limited
London First
London Luton Airport Operations Limited
London Luton Consultative Committee
Manchester Airport Consultative Committee
Manchester Airports Group
Natural England
Newcastle Airport Consultative Committee
Newcastle International Airport Limited
Northern Ireland Executive
Northern Way
Office of Communication (Ofcom)
Office of Fair Trading (OFT)
Office of Gas and Electricity Markets (Ofgem)
Office of Rail Regulation (ORR)
Office of Water Services (Ofwat)
Passenger Focus
Peel Airports Limited
Postal Services Commission (Postcomm)
Regional Development Agency
Robin Hood Airport Doncaster Sheffield
Ryanair
Scottish Government
Southampton (Eastleigh) Airport Consultative Committee
Stansted Airport Consultative Committee
Stop Stansted Expansion
Strategic Aviation Special Interest Group (SASiG) of Local Government Association
Sustainable Development Commission
Thames Valley Economic Partnership
Trades Union Congress
TUI Travel
UK Border Agency
Virgin Atlantic Airways
Welsh Assembly Government
Which?
Annex 3 – The current regulatory framework

Introduction
1.1. This annex summarises the main provisions of the current statutory regulatory framework for the economic regulation of UK airports.

Economic regulation of airports
1.2. Under current arrangements, the CAA has a discrete set of duties for the purposes of economic regulation which were set down 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:

i. to further the reasonable interest of users of airports within the UK;
ii. to promote the efficient, economic and profitable operation of such airports;
iii. to encourage investment in new facilities at airports in time to satisfy anticipated demands by users of such airports; and
iv. to impose the minimum restrictions that are consistent with performance by the CAA of these functions.

In addition, there is a requirement for the CAA to take account of international obligations.

1.3. Currently, Heathrow, Gatwick and Stansted airports are designated by the Secretary of State under Section 40(10) of the Airports Act 1986 (although Manchester airport will be de-designated with effect from the end of March 2009). Such designation places an obligation on the CAA to impose the following conditions on these airports:

i. price controls that limit the maximum revenue that they can recover from airport charges over a five year period;
ii. an accounts condition that obliges the airport to publish certain accounting information; and
iii. any public interest conditions required to remedy certain types of conduct identified by the Competition Commission.
The CAA makes its price cap decisions after having regard to advice from the Competition Commission. Prior to putting in place a price cap, there is a mandatory reference by the CAA to the Competition Commission. As part of the mandatory reference the Competition Commission considers whether there are any public interest issues that should be addressed by the CAA, and the CAA is required to address these issues by imposing appropriate conditions on the airport.

New price caps have recently been put in place by the CAA for Heathrow and Gatwick airports. Details of these price caps can be found at http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_mar08.pdf. The CAA is currently in the final stages of setting the price cap for Stansted Airport. The decision on airport charges at Stansted for 1 April 2009 to 31 March 2014 will be issued in March 2009. The CAA's latest proposals for airport charges at Stansted can be found at http://www.caa.co.uk/docs/5/ergdocs/081209StanstedProposals.pdf.

All airports that have had an annual turnover of more than £1m in two of the last three years are required to seek permission from the CAA to levy airport charges. The airports in the UK holding the necessary permission from the CAA to levy airport charges are listed at http://www.caa.co.uk/docs/5/ergdocs/general_guidance.pdf.

The CAA can impose discretionary conditions on any regulated airport in two circumstances. First, it can impose the accounts condition that applies to designated airports to other regulated airports. The airport has two months in which to make representations if the CAA proposes to impose the accounts condition. Second, the CAA can impose conditions where it finds an airport in breach of the provisions of Section 41 of the Airports Act 1986, which relates to anti-competitive conduct. More details about the CAA’s “Section 41 powers” can be found at http://www.caa.co.uk/docs/5/ergdocs/section41policy.pdf.

More details of the current regulatory regime can be found on the CAA's website at www.caa.co.uk by following the links to economic and airport regulation.

International obligations

The UK is a party to various international and European conventions, treaties and agreements. The key ones have been summarised below. These would be very difficult to vary or set aside and, for this reason, any changes to the existing framework for economic regulation of airports will have to accept these obligations as a “given” and not frustrate or undermine their effective application.
1.10. The **Chicago Convention** provides for the following obligations on contracting states when imposing charges on the airlines of another contracting state:

i. Every airport in a contracting state shall be open under uniform conditions to the aircraft of all other contracting states.

ii. Any charges made for the use of an airport on an aircraft from another contracting state (whether or not the aircraft is engaged in scheduled international air services), may not be higher than those that would be paid by national aircraft engaged in similar operations.

iii. All such charges are to be published and communicated to the International Civil Aviation Organization (ICAO).

1.11. The **ICAO** has adopted **policies on charges for Airports** that include, *inter alia*, the principles of cost-relatedness of charges, non-discrimination and an independent mechanism for economic regulation of airports. The UK’s position is that these recommendations of policy are not as binding as obligations under international agreements. They do however, reflect principles and obligations covered by the Chicago Convention and the EU/US Agreement (see below) and further guidance, such as:

- The cost basis for airport charges and airport service charges – Airports should maintain accounts that provide a satisfactory basis for determining and allocating the costs to be recovered and should regularly publish their financial statement and provide adequate financial information to users.

- The **EU/US Air Transport Agreement** provides for the following obligations on charging to apply to parties to the agreement when imposing charges on the airlines of another party:
  - The user charges that may be imposed by a charging authority must be just, reasonable, not unjustly discriminatory, and equitably apportioned among categories of users.
  - The user charges must not be less favourable than the most favourable terms available to any other airline at the time the charges are assessed.

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107 Virtually every state in the world is a signatory.
108 Article 15.
110 This agreement replaces Bermuda II, which is now in suspension as regards everything except flights between UK overseas territories and the US. There are two stages to the EU/US Agreement. Stage 1 is complete and Stage 2 is under negotiation. The UK will ratify the Agreement only once Stage 2 is complete. In terms of practical effects it is the EU/US agreement that applies. A copy can be found at: OJ 2007 L134 p.4.
111 Parties to the Agreement include the US, the European Community and its Member States.
112 “User charge” means a charge imposed on airlines for the provision of airport, airport environmental, air navigation, or aviation security facilities or services including related services and facilities.
113 There is no definition given in the agreement of these qualitative factors.
Reforming the framework for the economic regulation of UK airports

- The user charges may reflect, but not exceed, the full costs\textsuperscript{114} to the charging authority of providing the appropriate airport, airport environmental, air navigation, and aviation security facilities and services at the airport or within the airport system. Such charges may include a reasonable return on assets, after depreciation.

- Dialogue between charging authorities and airlines is encouraged to enable an accurate review of the reasonableness of charges, and authorities are encouraged to notify airlines in advance of changes to user charges, to enable users to express their views before charges are made.

Other bilateral air services agreements

1.12. The UK has bilateral air agreements with over 130 other countries, which contain user charges articles. These agreements tend to follow the ICAO’s published guidance on user charges but will vary depending on the date of the agreement and the view of the other country to the agreement. The standard rules that the UK will try to agree when negotiating a bilateral agreement are very similar to that described under the EU/US Agreement

\textsuperscript{114} ‘Full cost’ means the cost of providing service plus a reasonable charge for administrative overhead.
## Annex 4 – Environmental Law that impacts on airport developments

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<tr>
<th>Legislation name</th>
<th>Overview of Legislation</th>
<th>Impact on airport developments</th>
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<tr>
<td>Environmental Protection Act 1990 (Part IIA) (contaminated land regime)</td>
<td>The contaminated land regime requires the identification of a “chain of pollution” for liability to apply. This means there must be an identifiable source of pollution, a pathway for the pollution and a receptor (e.g. water, humans, houses) which is affected by that pollution.</td>
<td>A construction project associated with airport development has the potential to either cause pollution or to uncover pollution that is already existing at the relevant site. An airport could be liable in these circumstances either as a causer or knowing permitter or as an owner of the site. In practice, most major construction projects will (in conjunction with the planning process) undertake a ground investigation to determine the presence of any pollution ahead of construction works being commenced on site. Where pollution is identified, the developer will work with the enforcing authority/planning authorities to ensure that the remediation works are approved by them. Where a pollutant has not been identified and the construction works cause that pollutant to be disturbed/escape (e.g. to groundwater) then the airport is likely to be liable to cover the costs of any remediation (subject to any liability of the building contractors it engages under their terms of appointment).</td>
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<td>The contaminated land regime identifies two classes of appropriate persons who can be liable for contamination and can be required by the enforcing authority, the local authority or the Environment Agency (“EA”), to remediate the land in question. “Class A” who are “causers” or “knowing permitter” of contamination and “Class B” who are owners/occupiers of land. The regime will attribute liability for pollution to Class A persons in the first instance, but if no such person can be found liability will pass to a Class B person.</td>
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Local Authorities are required to identify contaminated land in their area and, in this situation or where contamination is revealed as a result of other activities on the land (e.g. development works, escape of pollution from the land etc), the enforcing authority is required to issue a remediation notice to the appropriate persons who have been identified in connection with the land. The remediation notice will specify what remediation is required and the timeframe within which it must be done. If the subject of a remediation notice does not comply with the notice, the enforcing authority can take action and recover its costs. It is open to a vendor and purchaser of land to vary the statutory position as regards liability. Most vendors will seek to transfer liability to the purchaser. |

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115 The definition of knowing permitter is an area of the regime that is relatively untested. Guidance from DEFRA explains that there are two elements to being a knowing permitter; (i) possessing knowledge that pollutants exist in, at, on or under the land and (ii) having the power to prevent that substance being there.
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<th>Legislation name</th>
<th>Overview of Legislation</th>
<th>Impact on airport developments</th>
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<td>Environmental Liability Directive (2004/35/EC) and Environmental Damage (Prevention and Remediation) Regulations 2009</td>
<td>The Environmental Liability Directive was supposed to have been transposed into UK legislation by 30 April 2007 but the UK missed that deadline. The Environmental Damage (Prevention and Remediation) Regulations 2009 were made on 29 January 2009 and will come into force on 1 March 2009. They apply to England only and separate equivalent regulations are expected during 2009 for Northern Ireland, Scotland and Wales. Under the Regulations, operators (people carrying out business activities) are liable for environmental damage and the imminent threat of such damage arising from occupational activities. Certain listed activities are deemed to be particularly risky and strict liability applies to any environmental damage caused by those (mainly industrial activities). For other activities, liability only applies to damage to protected species or natural habitats or a site of special scientific interest and there must be fault or negligence on the part of the operator. Unlike the contaminated land regime, this new regime will only apply to damage caused by emissions or incidents after the implementing legislation comes into force. Operators must take preventative action where possible, and remedial/restorative action if damage occurs, and if they fail to do so the regulator can take action and recover its costs. The level of remedial/restorative action required depends upon the type of damage which has occurred (distinctions are made between biodiversity/water damage, and land damage). There are overlaps with existing legislation such as the Water Resources Act 1991 and the Wildlife and Countryside Act 1981, and the Government intends to adopt a ‘flexible approach’ as to which legislation to use for enforcement if more than one regime can apply.</td>
<td>In the event of any environmental damage being caused as a consequence of an airport development project, the Environmental Liability Directive legislation could apply and in particular impose additional remediation/restoration requirements than would have applied under existing legislation.</td>
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<td>Legislation name</td>
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<td>Water Resources Act 1991 (S.161A to D - Works Notices) (S.85 - Pollution of controlled waters)</td>
<td>The Water Resources Act (&quot;WRA&quot;) is the main statutory control in respect of discharge of substances which may be classed as pollutants to watercourses. Substances likely to be discharged from an airport include fuels, trade effluents, waste and wash water run-offs and chemicals (such as de-icer). Surface water that runs over a site can be classed as a pollutant if it picks up polluting substances from the site. An EA discharge consent (and/or drain interceptors) will be required for any discharge that is not simply clean surface water. The WRA makes it an offence to &quot;cause or knowingly permit any poisonous, noxious or polluting matter or any solid waste to enter controlled waters&quot; without a consent or in breach of the terms of such consent. If pollution of &quot;controlled waters&quot; (virtually any inland waters and includes groundwater) occurs, the WRA could attribute liability to a person seen as causing or knowingly permitting this pollution. There are criminal fines and penalties for causing pollution of controlled waters. The EA can also serve Works Notices to require people to remedy or prevent water pollution (these are similar to remediation notices under the contaminated land regime).</td>
<td>Any water contamination and site drainage, discharge consents held or needed and any potential flooding problems will need to be assessed with an Environmental Impact Assessment (&quot;EIA&quot;) prior to any airport development or expansion. This is a requirement of the EIA but compliance with any drainage solutions assessed or put in place will be governed by the WRA. Any entry of site run-off or other chemicals into controlled waters (e.g. a nearby stream or groundwater underlying the site) as a result of a construction project associated with airport development will be an offence unless permitted by an EA discharge consent.</td>
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<td>Legislation name</td>
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<td>The Groundwater Regulations 1998 (SI 1998/2746)</td>
<td>The Regulations complete the implementation of the Groundwater Directive (Council Directive 80/68/EEC) for England and Wales. (They have now been revoked in relation to Scotland as the Water Services (Scotland) Act 2003 and the Water Environment (Controlled Activities) (Scotland) Regulations 2005 (SI 2005/348) provide the mechanism to regulate and authorise activities which impact on the water environment in Scotland). The Regulations introduce a consent regime to prevent direct or indirect discharges to groundwater of list I (black list) substances and to control pollution resulting from direct or indirect discharges of list II (grey list) substances. They require relevant constraints to be put into environmental permits and discharge consents granted under other legislation and provide for specific groundwater discharge authorisations (where these other permits are not in place). There are exclusions from the consent regime which include discharges in a quantity or concentration so small as to obviate any present or future danger of deterioration in the quality of the receiving groundwater. The Regulations give the EA a power to require the prevention or to control indirect discharges of black and grey list substances by issuing a notice. The Regulations amend the offence of water pollution under the WRA and thereby create a specific offence of discharging listed substances where there is a risk of indirect groundwater pollution.</td>
<td>Any discharges of black and grey list substances or disposal of any waste that could lead to the release of such substances to groundwater as a result of a construction project related to airport development will require a consent and may (if no consent is obtained or if the terms of any consent are breached) result in the commission of an offence.</td>
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<tr>
<td>Water Industry Act 1991</td>
<td>The Water Industry Act 1991 governs most aspects of sewer construction and use, including the adoption procedures and provisions regarding connection to existing sewers and the requisition of sewers over third party land, as well as sewer abandonment. This Act also governs the requirement for and operation of trade effluent consents, which are needed from the sewage undertaker for discharge of any effluent to the public sewers that is not just domestic sewage. Failure to comply carries criminal fines/penalties.</td>
<td>As a result of construction of new buildings, adoption and works in relation to sewers will be required for airport developments.</td>
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<td>Legislation name</td>
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<td>The Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations 2007 (SI 2007/991 as amended)</td>
<td>These Regulations implement the Energy Performance of Buildings Directive (2002/91/EC) in the UK. They aim to provide owners and occupiers of commercial buildings with information about the energy efficiency of their building. The Regulations require an asset rating - an Energy Performance Certificate (&quot;EPC&quot;) - of commercial buildings (in which energy is used to condition the climate of the building) upon construction, sale or letting. An EPC is needed when a building is marketed for sale or lease. The seller or landlord has responsibility for providing the EPC and its accompanying Recommendations Report to a prospective purchaser or tenant at the earliest opportunity which may include any of the following: (i) when written information is first provided to them, (ii) when the property is viewed or (iii) before the contract for sale or lease is signed. An EPC will also be required when a building is constructed, or if it is an existing building is modified so that it has a greater/fewer number of parts designed for separate use and the modification includes the provision/extension of building services (heating/hot water/air conditioning etc). It is the responsibility of the building contractor to provide the EPC to the building owner and notify the local authority Building Control team to this effect. Building Control sign off will not be achieved without an EPC being provided. The Regulations will need to be amended in response to the recast of the Energy Performance of Buildings Directive that was published in November 2008 but the timeframe for this has not yet been fixed.</td>
<td>These Regulations will require an EPC to be given by the building contractor to the building owner (the airport) on construction of any airport building that uses energy to condition its climate (e.g., a new terminal). The airport will have to provide an EPC to tenants of retail space within the airport when such units are let.</td>
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<td>Conservation (Natural Habitats, &amp;c.) Regulations 1994 (SI 1994/2716 as amended)</td>
<td>These Regulations place a statutory obligation on competent authorities in relation to any consents that may affect European Sites (Special Protection Areas and Special Areas of Conservation). If a consent is likely to have a significant effect on a European Site then an appropriate assessment must be undertaken. If the appropriate assessment does not enable a competent authority to ascertain that the consent will not adversely affect the integrity of a European Site than it cannot grant the consent unless there is an imperative reason of overriding public interest which has to be cleared with the Secretary of State. The Regulations also make it an offence to deliberately capture, kill, injure or disturb (subject to further conditions) any wild animal of a European protected species such as bats, great crested newts and otter. Unlike the WCA referred to below, the defence that such damage was incidental to a lawful operation, is not available. If European protected species are present on a development site, licenses can be obtained from DEFRA in relation to scientific research, ringing or marking, conservation/protection, preserving public health or safety or other imperative reasons of overriding public interest including those of a social or economic nature and beneficial consequences of primary importance for the environment. If the proposed site is in the vicinity of an SPA, SAC or candidate sites of either designation, or protected species are present, then the Regulations may affect the planning process for the construction/development of a new airport by way of noise, pollution, construction works, impacts on local hydrology etc.</td>
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<td>Wildlife and Countryside Act 1981</td>
<td>The WCA protects wild animals by imposing criminal liability on those persons that kill, injure or take them or in some cases recklessly disturb their place of shelter. There are various levels of offences which can apply to each listed species. There are various defences available under the WCA including the ability to claim that damage was unavoidable and incidental to a lawful operation. Licenses can be obtained from English Nature for acts that disturb etc. these animals that would otherwise be unlawful.</td>
<td>The construction works involved in the development of a new airport may involve the disturbance of protected species that are present on the proposed site. A licence will be required when protected species are known to be present but if offences are inadvertently committed there is a defence (subject to conditions) if the act concerned was the incidental result of a lawful operation and could not reasonably have been avoided.</td>
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<td>The Protection of Badgers Act 1992</td>
<td>The Act makes it an offence to kill or injure or attempt to kill or injure a badger. Interference covers damaging, destroying or obstructing access to a sett as well as causing a dog to enter a sett or disturbing a badger when it is occupying a sett. A licence may be obtained to interfere with a badger sett for the purposes of a development. Offences under the Act are criminal offences.</td>
<td>The construction work involved with the development of airports may involve the need to disturb badger setts. A licence will be required to undertake the movement of a badger sett in respect of such works.</td>
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<td>The Town and Country Planning (Environmental Impact Assessment) (England and Wales) Regulations 1999 (SI 1999/293)</td>
<td>The Regulations provide that a local planning authority or the Secretary of State is prohibited from granting a planning application until it has considered the contents of the Environmental Statement (if required). The Regulations establish a procedure for determining whether ‘development’ will require an EIA and hence an Environmental Statement. It is worth noting that the EIA Regulations take a very broad view of what ‘developments’ may require an EIA. For instance a recent European court decision has confirmed that an EIA will be required for any works to modify the infrastructure of an existing airport, even without extension of the runway, where those works may be regarded in particular because of their nature, extent and characteristics, as a modification of the airport itself and particularly if the works in question aimed to significantly increase the activity of the airport and air traffic.</td>
<td>These regulations are certain to apply to the construction/development of a new airport and any development of an existing airport which may increase airport activity or air traffic, meaning an EIA will be required. The EIA will need to cover many of the environmental issues listed in this report.</td>
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| Environmental Permitting (England and Wales) Regulations 2007 (SI 2007/3538)    | These Regulations (the “EP Regulations”) replaced the requirements in the Pollution Prevention and Control Regulations 2000 and Waste Management Licensing Regulations 1994 (which required organisations undertaking certain industrial activities and waste management/storage to obtain a permit or licence) with a single site based environmental permit. The EP Regulations did not change what or who was regulated under the preceding regimes nor the standards that such entities are required to meet although they did introduce a new system of standard permits for various listed activities that are considered to be a lower risk and in need of a lighter regulatory touch. Under the EP Regulations the following facilities need an environmental permit:  
  • an installation - meaning a facility carrying out any activity listed in the EP Regulations which cover the energy industry, metals industry, minerals industry, chemical industry, waste management and other activities;  
  • a waste operation - meaning any disposal or recovery of waste which is not exempt under the EP Regulations; or  
  • a mobile plant carrying out either of the above.  
Failure to obtain a permit and meet the conditions contained in it will be a criminal offence. A waste operation will not need a permit if it falls within any of the exemptions listed in the EP Regulations. Where a waste operation falls within one of the exemptions, the operator will need to register the exempt activity with the relevant authority. Failure to obtain a permit (or exemption) or to comply with the conditions of a permit are criminal offences under the EP Regulations. | The EP Regulations will require a permit to be obtained by the airport/the relevant buildings contractor in relation to any on-site storage, recovery or disposal of waste produced as a result of construction activities associated with airport development (e.g. a new terminal) unless there is a relevant exclusion or exemption. Potentially relevant exemptions include land reclamation or improvement (para 9 of Sch 2), construction and soil materials (para 13), storage of waste in a secure place (para 17) and waste for constructions (para 19). Where a relevant exemption exists registration of the exempt activity with the relevant authority will still be needed. |
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<td>Part II of the Environmental Protection Act 1990, Environmental Protection (Duty of Care) Regulations 1991 (SI 1991/2839 &amp; SI 2003/63), Controlled Waste (Registration of Carriers and Seizure of Vehicles) Regulations 1991 (SI 1991/1624)</td>
<td>Section 34 of the Act establishes the duty of care for waste, meaning that it is the duty of anyone who generates waste to take reasonable measures to ensure it is handled/ disposed of in accordance with the legislation. This duty is built upon by the Regulations which deal with requirements for documentation (transfer and consignment notes) when waste is transferred between holders, and for waste carriers to be registered. Records of waste transfer documentation need to be retained for two years.</td>
<td>In any airport development project, waste arisings will need to be handled in accordance with the duty of care and records need to be retained. This links with the Site Waste Management Plan requirements (please see below).</td>
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<td>Landfill (England &amp; Wales) Regulations 2002 (SI 2002/1599 as amended) and Hazardous Waste (England &amp; Wales) Regulations 2005 (SI 2005/894)</td>
<td>These Regulations implement the Landfill Directive (1999/31/EC) and have introduced new definitions of hazardous and non-hazardous waste (incorporating the European Waste Catalogue) and gradually introduced numerous restrictions on land filling between 2002 and 2007. They have also required waste to be more accurately described on transfer documentation and to be segregated and treated prior to any land filling.</td>
<td>Any waste arisings from development projects will need to be properly sorted and treated if they are to be landfilled. Certain wastes (e.g. liquid waste) cannot be landfilled and alternative disposal routes will need to be sought.</td>
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<td>Landfill Tax Regulations 1996 (SI 1996/1527 as amended)</td>
<td>Landfill tax is charged on the disposal of waste to landfill. These Regulations govern how this tax is applied and set out various exemptions. The standard rate of landfill tax is currently £32 per tonne for active waste and £2.50 per tonne for inactive waste, and it usually rises each year. Until 30 November 2008, developers could obtain an exemption certificate from HM Revenue and Customs to be able to landfill free of landfill tax waste arising from contaminated land redevelopment projects. Applications for exemptions were no longer accepted after 30 November 2008, but disposals made under those certificates can continue until 31 March 2012. A major legal case in 2008 (HMRC v Waste Recycling Group) also determined that landfill tax is not payable on material sent to landfill but used by the landfill operator for site works such as daily cover and construction of site roads, rather than being disposed of as waste.</td>
<td>Any waste arising from airport construction projects should be managed and disposed of in ways that minimises the landfill tax burden.</td>
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| Site Waste Management Plans Regulations 2008 (SI 2008/314) | These Regulations apply to any construction project with an estimated cost over £300,000 (ex VAT). Site waste management plans (SWMPs) must be in place for all such projects started after 6 April 2008. The obligations fall on the person who either carries out a construction project or commissions another to carry it out (the client) as well as the principal contractor.  

The SWMP must contain information about the project and the types and quantities of waste it will generate, as well as the waste management techniques to be employed. There are obligations to review and update the SWMP to compare the actual waste arisings with the plan. More detailed requirements to update and review the SWMP apply to projects over £500,000. | Construction projects to develop airports are likely to be over the £300,000 threshold so will require a SWMP to be put in place. It is also likely that such projects will fall within the category that require a more detailed approach. |
| Control of Asbestos Regulations 2006 (SI 2006/2739)    | These Regulations create duties upon any person who has contractual maintenance or repair obligations for non-domestic premises, or is in control of or has means of access to or egress from such premises (known as the dutyholder). The dutyholder must make a suitable and sufficient assessment as to whether asbestos is or may be present in the building and must then produce an asbestos register and manage any asbestos or suspected asbestos accordingly. By 1999 the use of building materials containing asbestos has been completely banned, therefore this is most relevant for buildings constructed prior to that date.  

Similarly, an employer must not carry out demolition or any other work which could expose employees to asbestos unless either he has carried out the assessment referred to above or assumes asbestos is present and acts accordingly.  

The Regulations prescribe procedures to be followed if any work is done to asbestos and set out an overarching duty on employers to prevent the exposure of his employees to asbestos so far as is reasonably practicable or where that is not possible, to reduce it to the lowest level reasonably practicable. | If any existing (pre-1999) airport/airline buildings are being altered or demolished as a result of an airport development project, then asbestos assessments will be required and any work involving asbestos will need to be managed in accordance with these Regulations. |
### CLIMATE CHANGE

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| The Greenhouse Gas Emissions Trading Scheme Regulations 2005 (SI 2005/925 as amended) | These Regulations implemented the EU Emissions Trading Scheme (EU ETS) Directive (2003/87/EC) and the Linking Directive (2004/101/EC). They establish caps on CO\(_2\) emissions for affected installations. The Regulations establish the permit regime, requirements for monitoring of emissions and submission of data and allowances for installations covered by the EU ETS Directive. Affected installations can trade CO\(_2\) allowances to meet their targets or benefit from over-performance against them. In December 2008 the EU Commission and the Council agreed the Climate Change and Energy Package that had been published in January of that year which amongst other things will introduce changes to the EU ETS. The EU Parliament then approved the package on 17 December. A number of directives will result from the package the first of which (Directive 2008/101/EC) relates to the inclusion of aviation within the EU ETS and was published in the Official Journal on 13 January 2009 (the “Aviation Directive”). The Aviation Directive must be transposed into UK law by 2 February 2010. The inclusion of the aviation sector (aircraft operators) under the Aviation Directive is on the following basis:  
- the cap or total quantity of allowances to be issued to aircraft operators will be 97% of historical aviation emissions (an average of annual emissions from 2004 - 2006) in 2012 which will fall to 95% in 2013 and in respect of subsequent years;  
- 3% of the allowances to be allocated to aircraft operators shall be set aside in a special reserve for new aircraft operators or those commencing additional activities;  
- 15% of allowances will be auctioned in 2012 and this percentage may change as a result of a general review of the Aviation Directive; | Heathrow, Gatwick Manchester and Stansted airports are currently included within the EU ETS (due to on-site power generation). British Airways Maintenance at Heathrow is also an EU ETS installation. New airports or extensions to existing airports may involve the installation of generating equipment that falls within the scope of the EU ETS. It is possible that, going forward, Stansted Airport may be excluded from the EU ETS on the basis of its level of emissions if it meets the 3MW de minimis threshold. The inclusion of the aviation sector in the EU ETS may result in a dampening of air growth which may reduce the benefits from airport development. New airport developments may receive an allocation from the new entrant reserve. |
### Overview of Legislation

- the allowances to be issued to aircraft operators are not available to other EU ETS installations to use to comply with their obligations under the EU ETS Directive but a gateway system may be included to facilitate trading between aircraft operators and other EU ETS installations following a general review of the Aviation Directive;

- at present there will not be a multiplier in respect of Nitrous Oxide emissions (which have an additional climate impact to CO2 emissions);

- in 2012 aircraft operators may use carbon credits (CERs and ERUs) obtained from projects created under the Kyoto Protocol’s flexible Mechanisms (CDM and JI) to satisfy up to 15% of the number of allowances that they are obliged to surrender. The amount of CERs and ERUs that may be used by aircraft operators in subsequent periods will be determined in light of changes being negotiated during 2009 to the international climate change agreement for post 2012.

### Impact on airport developments

- Amendments to the EU ETS which do not relate specifically to aviation have yet to be published in the Official Journal. Key proposals regarding EU ETS more generally include:
  - an emissions threshold of 25kt and an additional capacity threshold of 35MW for combustion installations;
  - auctioning of allowances rather than free allocation, starting at 20% of 2005 - 2007 verified emissions and increasing to 70% by 2020 with a view to reaching 100% by 2027;
  - creation of an EU wide New Entrant Reserve of 5% of the EU wide cap and the free allocation to new entrants would decrease in a linear fashion to zero by 2020; and
  - linking the ability to use Kyoto Protocol (CDM and JI) project credits to satisfy surrender obligations to an international agreement post 2012.
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| Climate Change Act 2008 | The Climate Change Act which received Royal Assent on 26 November 2008 establishes a cap on the UK’s CO2 emissions. It imposes a series of legally binding targets on the government for reducing CO2 emissions:  
  • a 26% reduction by 2020 below the 1990 baseline; and  
  • an 80% reduction below the 1990 baseline by 2050.  
A new system of legally binding five year “carbon budgets” will be set at least 15 years ahead. The first three of these carbon budgets (up to 2022) must be enshrined in regulations by June 2009.  
The Act also introduces new powers to enable the Government to more easily implement policies to cut emissions such as the introduction of new trading schemes. The Carbon Reduction Commitment referred to below will be the first example of the exercise of such powers.  
The Act establishes a system of reporting to Parliament, including a requirement for Government to report at least every five years on current and predicted impacts of climate change and to report not more than 30 months after a proposal for adapting to climate change was laid before Parliament.  
Emissions from domestic aviation (i.e. internal UK flights) are covered by the targets/budgets set out in the Act. In respect of international aviation emissions the Secretary of State at DECC must make regulations to include these emissions within the UK’s targets/budgets or report to parliament why this has not been done.  
The Act includes a provision requiring the Secretary of State to make regulations regarding corporate reporting requirements on greenhouse gas emission by 6 April 2012 (or report to parliament on why such regulations have not been made). The Secretary of State is also required to publish Guidance by 1 October 2009 on how emissions should be measured and calculated by companies that are required to produce business reviews under section 417 of the Companies Act. | As a result of the targets imposed on government by this legislation, it is likely that sectors that are not already subject to carbon reduction legislation will have targets imposed on them and that sectors that are currently subject to such requirements will find these requirements become more demanding.  
The likely future inclusion of international aviation within the Act’s targets will mean it will impact on policy regarding the development of airports.  
There is a tension between the Government’s desire to support UK industry (of which aviation is one sector) and the obligations in this legislation to reduce the UK’s CO2 emissions.  
As airlines and airports are unlikely to fall within the small companies exemption they will have to report on any emissions that result from airport developments and as a new airport or an extension to one is likely to increase emissions then this increase will need to be explained in accordance any guidance that is published by the Secretary of State. The reporting obligations may change as a result of the new reporting regulations that should be published by April 2012. |
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<td>Climate Change Act 2008</td>
<td>The Act establishes a new statutory body, the Committee on Climate Change, to provide independent expert advice and guidance to Government.</td>
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<td>(continued)</td>
<td>The Committee on Climate Change’s first task was to publish its advice to the Government on the level of the first three carbon budgets and its full review of the 2050 target.</td>
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<td>The Committee’s advice on the first three carbon budgets gives an intended budget reduction of 42 per cent against 1990 levels in 2020 (the intended budget assumes a new global deal is done on climate change), and an interim budget reduction of 34 per cent against 1990 levels in 2020 (which will be the target until a new global deal is reached).</td>
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<td>The Committee will report annually to parliament (the first report will be no later than 30 September 2009) on the UK’s progress towards achieving its targets and budgets.</td>
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<td>DECC intends to publish proposals for the levels of the first three carbon budgets alongside the main fiscal budget in spring 2009.</td>
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<td>In mid-2009, DECC plans to publish policies and proposals to meet the first three carbon budgets.</td>
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<td>Carbon Reduction Commitment (&quot;CRC&quot;) (NB not yet in force; a further consultation which will include the draft regulations is due out in spring 2009)</td>
<td>CRC is a mandatory, UK only, carbon trading scheme which is anticipated to start in 2010. It will operate as a cap and trade scheme within which organisations must purchase and surrender allowances to cover their annual CO₂ emissions. An organisation's energy usage during 2008 will determine if it is caught. If the organisation as a whole has consumed over 6,000 MWh of electricity during 2008 then it will be obliged to participate in the CRC unless one of the exemptions applies. Organisations covered by CRC will need to verify the electricity consumption through their half hourly meters from 1 January 2008 through to 31 December 2008 and register themselves as CRC Organisations between April and September 2010. The scheme will start with an introductory phase (1 April 2010 - the end of March 2013) where allowances to emit carbon will be sold at a fixed price £12 per tonne. The first capped phase with auctioning of allowances will start in April 2013. The cap will be decreased steadily over subsequent phases. Revenues from the auctions will be recycled to participants in the scheme (either as a bonus or penalty payment) depending on their position within a league table that will be constructed from the emissions data that they will be obliged to submit to the scheme administrator.</td>
<td>Airport buildings/airlines office buildings resulting from airport development are likely to be covered by the scheme. Airports and airlines will have to register as CRC Organisations, purchase allowances for, surrender and monitor their emissions and submit this data.</td>
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<td>Renewables Targets and the Renewables Obligation Order 2006 SI (2006/1004 as amended)</td>
<td>Under the Renewables Directive (2001/77/EC) the EU renewables targets are 12% of electricity must come from renewables by 2010. This target was amended by an announcement in March 2007 so that by 2020 20% of the EU's energy (not just electricity) must come from renewables. In the UK the current target is 20% by 2020 which was announced in the 2003 Energy White Paper and the mechanism for delivering this target is the Renewables Obligation. The Renewables Obligation Order sets a target of 7.9% of electricity supplied by electricity suppliers to come from renewable sources and this will rise to 15.4% by 2015/16. In June 2008 BERR consulted on how to meet the EU targets announced in 2007 and is due to publish the results of that consultation in its renewable energy strategy in spring 2009. The Energy Act 2008 made provision for amendments to be made to the Renewables Obligation Order to introduce banded ROCs (i.e. to allow different types of renewables generators to receive different amounts of ROCs for each MWh of power generated). A draft Renewables Obligation Order to introduce a banded system was issued in December 2008 and is anticipated to be in force by April this year. A new Renewable Energy Directive which will carve up the 20% target across member states is due to be published in the Official Journal imminently.</td>
<td>It is likely to be a condition of planning that airport developments include a renewables project which will power (at least in part) the development. Correctly structured documentation may allow ROCs to be obtained and sold on to electricity suppliers and any excess power not used by the airport may be sold to the National Grid.</td>
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<td>Planning Policy Statement 1 (&quot;PPS1&quot;) - Delivering Sustainable Development</td>
<td>PPS 1 and its Supplement provide that the key principles in drawing up development plans and taking decisions on planning applications include addressing the causes of climate change and taking into account the potential impacts of climate change. Mitigation of the effects of climate change will be achieved through planning policies and decisions that require the reductions of greenhouse gas emissions through energy efficient buildings and the use of renewable and low-carbon energy, CHP, community heating schemes as well as favouring urban growth that incorporates sustainable transport for freight, public transport and cycling and walking. Adaptation to the effects to climate change will be achieved through avoiding new development in areas at risk of flooding and sea-level rise and the use of sustainable drainage systems and the management of run-off.</td>
<td>Applications for development of airports will need to address the issues of building and transport emissions associated with the development and provide solutions that minimise such emissions. Renewable/low-carbon energy systems, CHP and community heating systems are all possible solutions that may need to be included within any application in order to meet the criteria laid down in the relevant Regional Spatial Strategy or Local Development Plan in order to obtain consent. Although the focus of this analysis is environmental law, it should be noted that changes made to the planning system in the Planning Act 2008 have amended the way in which large infrastructure projects such as airport developments are consented.</td>
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<td><strong>NOISE</strong></td>
<td>The Basic EASA Regulation is directly applicable in the UK and came into force on 4 April 2008. The Air Navigation (Environmental Standards) Order 2008 (SI 2002/798) which was the UK legislation that previously governed this aspect of aircraft noise and emissions was revoked from 20 December 2008, so the Basic EASA Regulation is now the primary UK legislation. In relation to noise it requires compliance with Annex 16 to the Chicago Convention. Regulation 1702/2003 similarly cross references to Annex 16 of the Chicago Convention. Annex 16 of the Chicago Convention sets out noise certification standards which different types of aircraft are required to meet.</td>
<td>The noise impacts of both ground and airborne operations have to be taken into account in relation to any airport development. Operation of these Regulations may also potentially impact on operational management.</td>
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<td>EC Regulation 216/2008 on common rules in the field of civil aviation and establishing a European Aviation Safety Agency (the “Basic EASA Regulation”) and EC Regulation 1702/2003 laying down implementing rules for the airworthiness and environmental certification of aircraft</td>
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<td>Air Navigation (Environmental Standards) for Non-EASA Aircraft Order 2008 (SI 2008/3133)</td>
<td>The Order requires noise certification for state aircraft, and other aircraft to which the Basic EASA Regulation does not apply (such as historic aircraft, very small aeroplanes and helicopters, gliders and microlights), as well as emissions certification, without which the specified aircraft cannot legally land or take off in the UK. In addition to criminal liability for contravention of the Order, there is power to prevent an aircraft flying.</td>
<td>The noise impacts of both ground and airborne operations have to be taken into account in relation to any airport development. Operation of this Order may also potentially impact on operational management.</td>
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<td>Aerodrome (Noise Restrictions) (Rules and Procedures) Regulations 2003 (SI 2003/1742)</td>
<td>These Regulations implement Directive 2002/30/EC and enable a Competent Authority to impose operating restrictions at city and other civil airports with substantial civil subsonic jet aeroplane traffic in order to address noise problems. There is a right of appeal against a competent authority determination or decision.</td>
<td>The ability to impose operating restrictions may affect ground operations and operational management and needs to be taken into account in the further development of any existing airport facilities.</td>
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<td>The Environmental Noise (England) Regulations 2006 (SI 2006/2238 as amended)</td>
<td>These Regulations implement, in England, Directive 2002/49/EC, the Environmental Noise Directive require competent authorities to make noise maps and make and adopt action plans in connection with various noise sources and locations, including both major airports and those airports that affect agglomerations (urban areas). For airports, the competent authority to make the noise maps and action plans is the Airport Operator. Once prepared, action plans are adopted by the Secretary of State for Environment, Food and Rural Affairs. The Secretary of State can exercise powers in default and recover associated costs. A major airport is defined as one which has 50,000 or more movements in a year, excluding training on light aircraft. In England, 15 such major airports were mapped for the first round (in 2007) with a further airports being mapped due to their proximity to agglomerations.</td>
<td>Adopted action plans for airports may impose restrictions in relation to airborne noise. Any airport development will therefore have to take into account the requirements of these plans in connection with land-use planning, operational management and the provision of noise mitigation or abatement facilities. Any airport development will also have to take account, where applicable, of adopted action plans for road and rail traffic in connection with surface access issues.</td>
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<td>Aeroplane Noise Regulations 1999 (SI 1999/1452 as amended)</td>
<td>These Regulations set out noise certification requirements for the UK use of propeller driven aeroplanes and civil subsonic jet aeroplanes. In addition to criminal liability for contravention of the Order, there is power to prevent an aircraft flying. The noise impacts of both ground and airborne operations have to be taken into account in relation to any airport development. Implementation of these Regulations may also potentially impact on operational management.</td>
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<td>Civil Aviation Act 1982 (as amended)</td>
<td>Amongst other things this Act provides that an Air Navigation Order (an Order which contains provisions to carry out the Chicago Convention or generally for regulating air navigation) can afford protection to actions in nuisance by making it clear that noise permitted by such an Order cannot be an actionable nuisance (s77). The Act also sets out the means of regulating noise and vibration from aircraft at designated aerodromes by way of notices to be given by the Secretary of State setting out specific requirements (s78). In addition to limited criminal liability there are powers for withholding aerodrome facilities and detaining aircraft for compliance purposes. As noted in chapter 5, the Civil Aviation Act 2006 introduced new powers in respect of noise control</td>
<td>The noise impacts of both ground and airborne operations can be controlled by this Act and must therefore be taken into account in relation to any airport development. The implementation of this Act may also potentially impact on operational management.</td>
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<td>Environmental Protection Act 1990</td>
<td>Subject to Civil Aviation Act protections (see above), this Act provides that noise emitted from premises so as to be prejudicial to health or a nuisance may amount to a statutory nuisance (whether it exists or is likely to occur or recur) in respect of which a local authority shall take enforcement action by way of abatement proceedings. Appeal against an abatement notice lies with the Magistrates’ Court.</td>
<td>The noise impacts of construction noise and ancillary operational noise arising through airport development may fall under the control of this Act. Noise abatement measures may be required.</td>
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<td>Town &amp; Country Planning Act 1990</td>
<td>If applicable, planning conditions and/or agreements entered into under s106 of this Act may contain controls or restrictions in relation to noise from airport operations. Planning conditions can be enforced through the criminal courts. Conversely Government planning guidance is designed to ensure that inappropriate new development is discouraged or prohibited around existing noise sources such as airports.</td>
<td>The noise impacts of both ground and airborne operations as well as road traffic noise arising from airport development are matters that can be subject to control under planning legislation. The implementation of these controls may also result in potential impact on land-use planning, operational management and require the provision of noise mitigation or abatement facilities.</td>
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<td>Control of Pollution Act 1974</td>
<td>A local authority may impose a notice under s60 of this Act specifying the way in which construction works are to be undertaken for the purpose of controlling noise production. It is also possible for a person carrying out construction works to apply for a consent from the local authority (s61) to carry out construction works in a specified manner. Breaching the terms of a notice or consent is a criminal offence.</td>
<td>The potential impacts of construction noise that may arise during the course of airport development can be controlled under this Act.</td>
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<td><strong>EMISSIONS TO AIR/AIR QUALITY</strong></td>
<td>Part IV of the Environment Act 1995 requires local authorities to review the quality of air within their area. The reviews have to consider the air quality for the time being and the likely future air quality. Such reviews have to be accompanied by an assessment of whether any prescribed air quality standards or objectives are being achieved or are likely to be achieved within the relevant period.</td>
<td>The air quality standards in the Regulations will be relevant to the Environmental Impact Assessment (&quot;EIA&quot;), which will be necessary on airport development. This EIA will, under the Town and Country Planning (Environmental Impact Assessment) (England and Wales) Regulations 1999, need to determine the extent of any exceedances predicted in relation to the air quality targets e.g. from road traffic emissions to air associated with airport development.</td>
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<tr>
<td>Part IV Environment Act 1995/Air Quality (England) Regulations 2000 (SI 2000/928) as amended by the Air Quality (England) Amendment Regulations 2002 (SI 2002/3043)</td>
<td>The Air Quality (England) Regulations 2000 set out the air quality objectives to be achieved in relation to key pollutants (benzene, 1,3-butadiene, carbon monoxide, lead, nitrogen oxide, PM10 and sulphur dioxide). PM10 is a particulate matter which meets specific criteria. Where any of the prescribed objectives are not likely to be achieved within any part of a local authority's area within the relevant period, the authority concerned will have to designate that part of its area as an air quality management area. An action plan covering the designated area will then have to be prepared setting out how the authority intends to exercise its powers in relation to the designated area in pursuit of the achievement of the prescribed objectives.</td>
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<td><strong>Air Quality Standards Regulations 2007(SI 2007/64)</strong></td>
<td>These Regulations came into force on 15 February 2007 and implement the EU Air Quality Framework Directive 1996 (96/62/EC ) and its four daughter directives. Specific limit and target values are set for a number of air pollutants including carbon monoxide, nitrogen dioxide, oxides of nitrogen, PM10 and sulphur dioxide. A duty to assess air quality is also placed on the Secretary of State. The Secretary of State is also required to make up-to-date information available to the public.</td>
<td>The standards in the Air Quality Standards Regulations 2007 will also be relevant to the EIA which is necessary on airport redevelopment under the Town and Country Planning (Environmental Impact Assessment) (England and Wales) Regulations 1999. This will need to determine the extent of any exceedances predicted in relation to the air quality.</td>
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<td>Legislation name</td>
<td>Overview of Legislation</td>
<td>Impact on airport developments</td>
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| EC Regulation 216/2008 on common rules in the field of civil aviation and establishing a European Aviation Safety Agency (the “Basic EASA Regulations”) and EC Regulation 1702/2003 laying down implementing rules for the airworthiness and environmental certification of aircraft | This Basic EASA Regulation is directly applicable in the UK and came into force on 4 April 2008. The Air Navigation (Environmental Standards) Order 2008 (S1 2002/798) which was the UK legislation that previously governed aircraft noise and emissions was revoked from 10 December 2008, so the Basic EASA Regulation is now the primary UK legislation. In relation to emissions it requires compliance with Annex 16 to the Convention on International Civil Aviation (the “Chicago Convention”). Regulation 1702/2003 similarly cross references to Annex 16 of the Chicago Convention. Annex 16 of the Chicago Convention sets out emissions standards adopted by the International Civil Aviation Organisation (ICAO) which different types of aircraft are required to meet. Emissions limits are set for:  
- Oxides of nitrogen (NO\textsubscript{x})  
- Carbon monoxide (CO)  
- Unburned hydrocarbons (HC)  
- Smoke (SN)  
The NO\textsubscript{x} standard has been reviewed and tightened three times. The latest Committee on Aviation Environmental Protection (“CAEP”) Standard, CAEP/6 came into force for newly certified types of aircraft at the beginning of 2008. Standards are binding on contracting parties to the Convention on International Civil Aviation of which the UK is one. | The ICAO Standards should be considered as part of airport development, for example when considering which airlines/aircraft are to operate from the airport ultimately. |
| Directive 2008/50/EC on Ambient Air Quality and Cleaner Air for Europe | This Directive seeks to streamline five existing pieces of environmental legislation, the existing Air Framework Directive and its four daughter directives, into one. The legislation focuses mainly on reducing emissions of key airborne pollutants, in particular the fine dust particles that cause a wide range of health problems. It promotes increased cooperation between the Member States in reducing air pollution. | The Directive is not aimed initially at the aviation industry; however it (and in due course implementing UK legislation) will need to be considered in respect of airport development. |
Annex 5 – Aviation and climate change

1. Overview of climate change targets

**International targets: The Kyoto Protocol**

1.1. The UK has a legally binding target under the 1997 Kyoto Protocol to reduce its greenhouse gas (GHG) emissions by 12.5% compared to 1990 levels, by 2012. It is very likely that the UK will go beyond its target by a considerable way. GHG emissions in 2006 were over 15% lower than 1990 levels.

1.2. With the Kyoto period ending in 2012, a successor treaty is currently being negotiated. There is currently considerable uncertainty about the form that such an agreement will take; negotiations are due to be finalised in Copenhagen in December 2009.

1.3. The Kyoto Protocol excluded emissions from international aviation and shipping from the targets and instead remitted consideration of these sectors to the relevant UN bodies – the International Civil Aviation Organisation and the International Maritime Organisation. The UK and EU recognise the need for these sectors to account for their emissions and are pursuing their inclusion in the post-2012 agreement at Copenhagen, so as to provide comprehensive emissions coverage.

**European targets: The 2020 Climate and Energy Package**

1.4. The EU has committed to GHG emissions reductions of:

- 30% against 1990 by 2020, under an international agreement with comparable effort from other developed countries, or
- 20% against 1990 by 2020, in the absence of such a deal.

1.5. These targets include emissions from international aviation, which is to be included within the EU Emissions Trading Scheme from 2012, as described in more detail below. They build upon the reductions achieved in the EU under Kyoto and provide continuity of effort in the current absence of a post-Kyoto deal.

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116 The GHGs are those specified under the Kyoto Protocol.
1.6. The EU has also set a target, through its Single European Sky programme, to reduce CO₂ emissions per flight in Europe by 10% through increased efficiency.

**UK targets: The Climate Change Act 2008**

1.7. Against this background and to demonstrate global leadership in tackling climate change, the UK has set itself a domestic target to reduce GHG emissions by at least 80% by 2050, and CO₂ emissions by at least 26% by 2020, against a 1990 baseline. In recognition of the move to a tougher 2050 target, the 2020 target is due to be reviewed. To ensure that the UK is set on a trajectory to meet these targets, the Climate Change Act established a carbon budgeting system.

1.8. The Climate Change Act includes domestic aviation emissions, but excludes international aviation emissions, because of the lack of an internationally-agreed method for allocating emissions to individual countries and the difficulty of reconciling the UK framework with the approach taken in the EU ETS. The Committee on Climate Change (CCC) recommended on 1 December 2008 that the scope of the targets and budgets in the Climate Change Act should not be extended to include international aviation and shipping. However, like the Government, the CCC also believes that international aviation and shipping emissions should be included in the UK’s climate change strategy. This could mean that in due course these emissions are included in some separate multilateral framework, or it could mean they are included within the UK’s domestic framework – these matters are the subject of ongoing international discussions.

**UK targets: Aviation-specific targets**

1.9. In January 2009 an aviation-specific target was set to reduce CO₂ emissions from aviation in the UK in 2050 to below its 2005 level. The CCC has been asked to advise on the best basis for measurement of this target.

2. **Overview of EU climate change policy**

2.1. The principal Europe-wide climate change policy is the EU Emissions Trading Scheme (EU ETS), which currently covers just over 40% of EU GHG emissions, primarily CO₂ emissions from power generation and heavy industry. Overall emissions in the scheme are capped at a specified level, and emissions allowances up to this level are available for trade. As businesses must surrender allowances to cover their emissions, total emissions must equal the overall cap. Emissions reductions will have to occur to meet a tight cap, and trading of allowances means this will occur where abatement is cheapest.
2.2. From 2012 all arriving and departing flights from EU airports will be covered by the EU ETS, with emissions initially capped at 97% of average 2004-06 emissions, tightening to 95% of average 2004-06 emissions from 2013. Any emissions above this cap will need to be accounted for by airlines securing reductions from other sectors within the EU ETS.

2.3. Whilst there are some EU measures such as tougher car CO\textsubscript{2} emissions standards that will reduce non-ETS emissions, Member States must implement their own policies to achieve the bulk of the non-ETS abatement. The other key policy in the UK that will affect the aviation sector is the Carbon Reduction Commitment (CRC), due to commence in 2010. Like the EU ETS, it will be a mandatory cap-and-trade scheme but will instead target large, non-energy intensive business and public sector organisations’ direct CO\textsubscript{2} energy and indirect electricity use. The total energy use emissions (excluding transport emissions, EU ETS emissions and emissions covered by Climate Change Agreements) of organisations covered by the CRC will be capped, with the level of the caps – and thus the reduction effort required – yet to be set. This scheme is therefore intended to complement existing trading schemes, such as the EU ETS, and will be compatible with the UK carbon budgets. The Government will announce its decision on the carbon budgets, having taken account of the CCC’s advice, and the policies by which the budgets will be met, during 2009.

3. How UK aviation sector is covered by climate change policy

3.1. The majority of emissions in the aviation sector are emitted during flight. Other direct sources of emissions include emissions from aircraft on the ground (taxiing, queuing and testing their engines), emissions from on-site plant such as boiler systems and from surface access to and around airports. Indirect sources of emissions are building emissions (electricity use associated with lighting and temperature control systems produces emissions upstream at the point of generation) and emissions from airport waste (released as it biodegrades).

3.2. The Government has a comprehensive approach to addressing aviation’s CO\textsubscript{2} emissions, encompassing technological, air traffic management, operational and market-based measures.

3.3. International aviation emissions are already implicitly factored in to the CCC carbon budget proposals under the Act, as the CCC has acknowledged. The CCC’s proposals were based on the EU 2020 Climate and Energy Package to achieve a 20% reduction in emissions across all sectors, including aviation. Aviation is locked into that reduction by its emissions cap in the EU Emissions Trading Scheme. So aviation emissions are already being reduced in a way that is entirely consistent with the CCC’s budget proposals.
3.4. Due to their size, emissions from the boiler plant of four airports (Gatwick, Heathrow, Manchester and Stansted) are currently covered by the EU ETS, as are emissions from the maintenance base of British Airways, based at Heathrow. Use of grid electricity is also indirectly covered, since power generators are in the EU ETS so the cost of emissions allowances will be priced into the cost of grid electricity.

3.5. When the CRC is introduced in 2010 this will cover emissions from energy use in airport buildings. Emissions from boiler plant covered by the EU ETS will not be covered by the CRC as well. Revisions to the EU ETS effective from 2013 may affect the coverage of the aviation sector by the scheme, but emissions that fall out of the EU ETS will have to be covered by the CRC instead.

3.6. The Government response to the Committee on Climate Change’s recommended budgets, and the policies by which they will meet the budgets, are due to be announced during 2009.

4. Impacts for the aviation sector of its coverage by climate change policy

4.1. Participation in a trading scheme such as the EU ETS or the CRC will increase the operating costs of a business. The extent to which these costs can be passed through to consumers depends in part upon the competitiveness of the market in which the business operates and is likely to vary across the aviation sector.

4.2. The requirement to account for its climate change emissions will provide the aviation sector with the incentive to be more efficient in terms of its operations and deployment of aircraft fleet. These incentives are likely to become even stronger over time as demand for air travel continues to grow; but so will the opportunities for efficiency gains.

5. Ensuring a sustainable UK aviation industry

5.1. The UK Government is committed to encouraging and supporting the industry to reduce its climate change emissions through technology development as part of its comprehensive approach to tackling aviation’s climate change effects.

5.2. The Government is contributing to the European “Clean Sky” research programme. Between 2008 and 2014, this is funding 1.6 billion Euros on projects such as improving wing design, improving materials and developing more efficient engines. In addition the UK is taking forward its National Aerospace Technology Strategy on which the Government has committed over £230m since 2004, with industry investing at the same level.
5.3. There are strong cost incentives for the industry to modernise its fleet – more efficient aircraft means better management of costs. But Government wants to strengthen those incentives. The demanding future CO₂ standards as a requirement for cars have no equivalent in relation to aviation. The Government has announced that it will be pressing for such international standards in aviation.

5.4. At Heathrow, the Government has announced its support for additional capacity and will be consulting on the introduction of “green slots” so that when new air traffic movements are permitted, they will only go to the most modern aircraft.

5.5. The airline industry is showing strong interest in bio-fuels. The effort is accelerating. Virgin Atlantic undertook the first bio-fuel trial in March 2008. At the end of 2008 Air New Zealand conducted a trial using Jatropha-based fuel and shortly after Continental Airlines conducted a trial using algae-based fuel.

5.6. The European Commission is commissioning a report on the feasibility of bio-fuels for aviation. And the International Civil Aviation Organisation is holding a major bio-fuels workshop in February. These will inform consideration of how best to develop a UK Government strategy on this issue.
Annex 6 – Questions for Stakeholders

6. 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.

7. 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 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?

8. 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.\(^\text{117}\)
  - 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.

\(^{117}\) This option has been proposed by the Review’s independent Expert Panel.
9. **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 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?
10. 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?