CAA consultation on Commitments at Gatwick Airport in Q6

Response by British Airways August 2013

Introduction

British Airways worked with the Gatwick ACC to develop a joint response to the CAA's letter of 8th July: "Gatwick Airport Limited – proposed licence conditions under Section 18 of the Civil Aviation Act in relation to price commitments." British Airways broadly supports the ACC response and will not repeat the points made there. In this response, we attempt to explain BA's overall position and to make some additional points.

The need for a licence

British Airways is clear that an approach based on Commitments could not work without them being incorporated into a licence, for reasons explained in our previous submission (response to the CAA Initial Proposals for Q6). We acknowledge the CAA's efforts to address our previous concerns and to set out a licence framework that incorporates the Commitments. The ACC paper sets out more detailed comments on the CAA's proposed licence conditions, including suggestions for revisions.

The impact of market power

British Airways agrees with the CAA that Gatwick Airport has significant market power. This gives them bargaining power over most airlines. British Airways has submitted evidence to the CAA explaining why we have no realistic alternatives for our Gatwick operation.

Because of this fundamental imbalance in negotiating leverage, it is important to passengers and to airlines that effective licence-based constraints are imposed by the CAA to manage the risk of abuse. The airport has, in several responses to the CAA, made clear its desire to increase prices.

The situation is therefore very different from airports without market power, where contracts are normal and can be freely negotiated based on mutually beneficial terms. We are doubtful that commercial contracts will be agreed at Gatwick, given GAL's market power, and are not aware that any have been so far, despite strong encouragement from the CAA and a willingness by several airlines, including British Airways, to explore the scope for this.

BA considers that it is the presence of market power that has prevented the development of contracts and not the form of regulation. It seems no more likely that commercial contracts would be agreed under Commitments than under a RAB based licence under the new Civil Aviation Act 2012. A RAB based settlement could facilitate contracts, were they to emerge (perhaps by a supportive comment in the regulatory policy statement), and we see no intrinsic constraints to commercial contracts imposed by a RAB based approach.

We have therefore considered whether GAL's Commitments, incorporated into a licence in the way envisaged by the CAA, would be likely to constrain GAL's market power. We also considered whether Commitments would offer net advantages to passengers over a RAB based approach.

The disadvantages of GAL's Commitments

BA considers that GAL's proposed Commitments would not constrain GAL's market power and would offer no clear advantages to passengers over a RAB based approach, but would have a number of disadvantages:

- Airport charges would be higher under Commitments (GAL's proposal is RPI+2.5% compared with the CAA RAB proposal of 0% and BA has provided evidence that an efficient settlement would be RPI-10%);
- To the extent that any efficiencies are realised, they would accrue to GAL's shareholders and not to passengers;
- Airlines would be subjected to additional price risks and uncertainties, for example from uncapped premium service charges (which could cover facilities currently covered by regulated airport charges); from the abolition of the public interest protection on non-regulated charges such as check-in and baggage and staff car parking; and from the open ended costs of second runway and additional security costs. These additional costs would be passed on to passengers in one form or another.
- Investment would be likely to reduce significantly given that future profits would no longer depend on the RAB. Therefore worthwhile projects could be subject to cancellation or delay if it were not in GAL shareholders' interests to deliver them. Under commitments, GAL would be incentivised to prioritise investment in projects that offered its shareholders commercial returns (retail etc), ahead of investing in infrastructure that support the passengers interest. The Commitments contain no guarantees that any projects would be delivered. The SQR regime, which would be weaker under GAL's proposal, would not provide adequate financial incentives. The new approach would also provide GAL with the opportunity to game the Commitments by forcing airlines to agree to price increases before they agree to deliver particular projects and infrastructure required to support the passenger interest.
- GAL would be able to change the terms of the Commitments too easily and to make controversial changes. If a non-licence change process is to be included, it should be reserved for uncontroversial changes where there is unanimous or near unanimous support of airlines representing around 90-100% of passengers. The

proposed 51% support for change is far too low and would result in airlines being unable to rely on the Commitments price for the 7 year period.

- The new approach would be more complex and expensive to monitor by airlines with disputes being more likely than under a relatively simple RAB based approach. Particular features, such as the Cumulative Revenue Difference, seem to add very little value (while increasing complexity and price uncertainty for airlines) compared with the established Correction Factor mechanism.

It is worth noting that key protections in the Q5 settlement, that would be lost under Commitments[1], reflect proportionate responses to real issues that materialised under previous price periods. We see little reason to discard these protections if it is passenger interests, rather than GAL's interests, that are paramount.

British Airways therefore does not support GAL's proposed Commitments in their current form, as we consider they would be seriously detrimental to passenger interests. We understand the CAA is keen to explore the scope for changes to the regulatory approach where this reduces regulatory costs and results in more normal commercial arrangements. BA shares these objectives, but we have concluded that GAL's proposal in its current form would not be effective in constraining GAL' s market power and would not be in the interests of passengers.

[1] including capex triggers, light touch measures such as the transparency and cost reflectivity arrangements for non-regulated charges and the RAB investment incentive