

REFORM OF THE FRAMEWORK FOR THE ECONOMIC REGULATION OF AIRPORTS

What this paper is about

To update the Liaison group on the proposed reform of the framework for the economic regulation of airports. The paper provides details about the EU Airport Charges Directive (ACD), the proposed new airport licence regime, developing the role of *Passenger Focus (PF)* to represent the interests of air passengers and the DfT's review of the Guidelines for Airport Consultative Committees. Delegates should note that it is not yet known how the new Government will take forward the proposed reforms.

Points for Discussion

To consider the proposed structure of airport licences as suggested by the CAA and whether any comments should be submitted to the CAA or the DfT.

Following the in-depth discussion with the DfT, the CAA and PF the previous afternoon, to consider whether to submit suggestions to the DfT, CAA and/or PF on possible ways of working with airport consultative committees.

Whether there are any other matters that delegates would like the DfT to consider as part of its review of the guidelines for airport consultative committees.

Points for Possible Action

The meeting will wish to decide whether to submit any representations in respect of the points listed above.

Introduction

1. The former Government launched a consultation in March 2009¹ on its proposals to update and reform the framework for the economic regulation of UK airports. The proposals were wide ranging and covered a number of aspects of the way in which airports are regulated. Delegates will recall that at the Annual Meeting in Belfast last year, the Liaison Group supported the overall principle of the proposals as they would create a transparent and effective regulatory regime consistent with the aims of the new EU Airport Charges Directive (ACD). In particular, the Liaison Group believed that introducing a licence-based system would bring into line airports regulation with other more modern economic regulatory regimes in the UK such as energy, water and rail.
2. The Liaison Group also welcomed the greater recognition given to environmental issues, the acceptance of the need for appropriate funding for the regime and the need for a strong advocacy body for passengers. However, there was strong opposition to the former Government's proposal to give *Passenger Focus (PF)* a wider remit to cover air passenger interests at a national level. Delegates will recall that at last year's annual meeting, the Liaison Group agreed to put forward an alternative proposal involving a broadening of the remit of the *Air Transport Users Council (AUC)* and to give it enhanced powers and budget.
3. On 10th December 2009², the former Government announced its decision on the future economic regulation of airports. Having considered responses to the consultation, the former Government said it intended to introduce as soon as parliamentary time allowed a package of reforms that:
 - Modernise the statutory duties of the *Civil Aviation Authority (CAA)*. The CAA's existing duties would be replaced with a single primary duty to promote the interests of end consumers of passenger and freight services at airports. In order to provide clarity about the additional factors the CAA would need to take into account in making decisions, the former Government also proposed to introduce new subordinate duties.
 - Introduce a new licensing regime that is flexible and targeted. The new regime would give the regulator sanctions and enforcement powers to incentivise licensee compliance. More details about the proposed licencing regime is given below.
 - Introduce a new framework of merit based appeals to ensure the regulating body is accountable for the decisions it makes.
 - Enhance passenger representation within the aviation sector. To ensure that passengers have an independent and influential advocate with an end-to-end journey perspective, the former Government said it would introduce legislation to make PF the passenger representative body for aviation. PF would build on the firm foundations established by the AUC. More details about this are given below.
 - Promote the financial resilience of major airports. In October 2009, the then Secretary of State brought forward the announcement on financial resilience in order to provide as much certainty as possible for the industry and its investors, and support sustained investment.
4. The Executive Summary of the proposals is set out in Annex 1.
5. The CAA welcomed the proposals as they would provide a balanced set of objectives which would allow the CAA to operate more effectively as well as ensuring 'Better Regulation' thus minimising the burden that regulation brings on the industry. The CAA believes that operating in accordance with the proposed new duties would mean that it would need to work more closely with airlines and other stakeholders to better understand different perceptions of passenger interests.
6. It should also be noted that as a result of the findings of the *Competition Commission* and in the light of the Government's review, the CAA consulted on initial objectives and the process of developing competition guidelines and alternative approaches to economic regulation that would support its proposed new duties. The CAA said it expected to consult

¹ <http://www.dft.gov.uk/consultations/closed/ukairports/>

² <http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationukairports/decisiondocument/>

on initial options for alternative price controls and the proposed competition guidelines later in 2010³.

7. At the same time of announcing its decision, the former Government published two further consultations. The consultations related to:
 - *Promoting the Financial Resilience for Major Airports*⁴ – the document sought views on the Government’s proposals to introduce a licence condition requiring airport operators in Tier 1 to produce and maintain a continuity of service plan and to introduce a requirement for the regulator to meet additional conditions before ‘switching on’ elements of the ring fence that have been granted derogations upon the introduction of the licence. The consultation closed on 4th February 2010. As this consultation only related to Tier 1 airports (Heathrow, Gatwick and Stansted) the UKACCS Working Group, at its meeting on 26th January 2010, agreed not to provide a collective response.
 - Further proposals to modernise the *Regulatory Framework for Aviation*⁵ – the document sought comments on the proposed statutory framework of the CAA and a range of ways the regulations for the *Air Travel Organisers’ Licensing (ATOL)* could be reformed. The consultation closed on 17th March. The UKACCS Working Group considered the general principles of the reforms and agreed to submit a collective response highlighting:
 - disappointment that it had been decided to broaden the remit of PF to represent air passengers.
 - the desire to have the opportunity to help develop the new role for PF would be welcomed. The Liaison Group felt there was a need to ensure that the voice of air passengers at individual airports is taken fully into account in the advice PF gives to the CAA and the Government.
 - general support for the three proposed general objectives for the CAA (consumer, safety and environment) as the basis of the CAA’s future work but expressing the need to ensure that safety is always regarded as the highest priority and which should not be compromised in pursuing of the other objectives.
 - support for the ATOL scheme to be updated
 - support for the modernisation of the airport byelaw making procedures.
8. Delegates will be interested to note that in the CAA’s response to the DfT it advised that it believed the three proposed general objectives (safety, consumer and environment) reflected current priorities and would provide a strong foundation for the CAA to meet its future challenges. The CAA strongly supported the emphasis placed on safety and the need for the CAA to maintain its focus on securing high standards of safety.
9. It is not yet known how the new Government will take forward the proposals for change.

Airport Charges Directive

10. The *Airport Charges Directive 2009/12 (ACD)*⁶ was finally signed off in March 2009. From the 15th March 2011 airports across Europe with more than 5 million passengers will be required to comply with the provisions of the ACD. The ACD applies to all airports with more than 5 million passengers per annum and to airports with the highest number of passengers in each member state. When the Directive was issued, based on the CAA’s 2008 traffic figures 13 UK airports were above this threshold namely Heathrow, Gatwick, Stansted, Manchester, Luton, Birmingham, Edinburgh, Glasgow, Bristol, East Midlands International, Liverpool, Belfast International, and Newcastle. However, on the basis of traffic figures for 2009 only nine UK airports are above this threshold (East Midlands International, Liverpool, Belfast International and Newcastle now fall below the threshold).
11. The key provisions of the ACD are:

³ <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=68>

⁴ <http://www.dft.gov.uk/consultations/closed/financialresilience/>

⁵ <http://www.dft.gov.uk/consultations/closed/regulatingairtransport/>

⁶ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:070:0011:0016:EN:PDF>

- *Non-discrimination (Art 3)*
 Airport charges must not discriminate amongst airport users (i.e. airlines), This does not prevent differentiation of charges for issues of public and general interest including environmental issues.
- *Consultation (Art 6.1, 6.2 and 8)*
 Airport managing bodies must consult airport users annually on airport charges and service quality levels, except where otherwise provided for by multi-annual agreements. A timetable would be established for consultation on changes to the structure and level of charges. In addition, airport managing bodies must consult airport users before new infrastructure plans are finalised.
- *Remedy (Art 6.3 and 6.4) and derogation from remedy (Art 6.5)*
 Where airport managing bodies and airlines cannot agree on proposed changes to airport charges, there is a right of appeal to an independent supervisory authority established or nominated under the Directive. However, Member States need not apply this right at airports where:
 - the independent regulator approves or determines airport charges or their maximum level under a mandatory procedure in national law; or
 - there is a mandatory procedure under national law to review the effectiveness of competition on a regular basis or on request from interested parties, and, if warranted on the basis of the review, airport charges or their maximum level are determined or approved by the independent regulator.
- *Transparency (Art 7)*
 Airport managing bodies have to provide airport users with information about cost structures and revenues relevant to charges, as well as other information each time they consult about airport charges. Airlines have to provide airports with specified information including their traffic forecasts and requirements at the airport.
- *Quality standards (Art 9)*
 Airport managing bodies and airport users may enter into service level agreements.
- *Differentiation of services (Art 10)*
 Airport managing bodies can vary the quality and scope of airport services, terminals or parts of terminals to provide tailored services or dedicated facilities.
- *Independent supervisory authority (Art 11)*
 Member States have to establish or nominate an independent supervisory authority to ensure correct implementation of the ACD and also to resolve disputes over airport charges referred to it under article 6, where relevant:

12. The DfT intends to implement the ACD in the UK through secondary legislation as an interim measure until new primary legislation giving effect to the new licence regime (as discussed below) is passed. The DfT aims to consult on the ACD implementation instrument during Summer 2010.

Proposed New Airport Licences

13. The former Government confirmed its proposal for Tier 1 and Tier 2 airport licences. Tier 1 licences will be for those airports with substantial market power and for which general competition law is unlikely to be sufficient to address potential risks of abuse of market position and for which regulatory intervention is warranted. Heathrow, Gatwick and Stansted airports currently fall into this category. Tier 2 licences would be for airports with more than 5 million passengers per annum, which is consistent with the ACD. Delegates will be pleased to note that the former Government decided not to pursue the option of Tier 3 licences.
14. The then Secretary of State also confirmed that the new licencing regime would not affect the basis on which the current price caps were set at the designated airports for economic

- regulation. Therefore, unless Heathrow, Gatwick or Stansted are de-designated during the current price control period and assuming the licences are issued during that period, the three London airports will be issued with a Tier 1 licence. The criteria for deciding whether an airport has a Tier 1 licence will be enshrined in primary legislation.
15. At the time of announcing his decision on the regulatory reforms, the then Secretary of State asked the CAA for advice, under s.16 of the Civil Aviation Act 1982, on the drafting of some of the conditions that would form part of the future licences under the proposed new regulatory regime including specific categories of licence conditions, and the possibility of conditions relating to PF. In addition, the CAA was asked to provide advice on the following issues:
 - the structure of the licence and powers to modify specific licence conditions;
 - whether there are any international obligations (other than the ACD) that should be included in the licences; and
 - the appropriateness of using “sunset clauses” for specific licence conditions.
 16. The CAA was requested to provide its advice by May 2010. The CAA’s advice would be considered before the Government consulted on the full initial licences to be issued.
 17. In developing its thinking and advice to the Secretary of State, the CAA invited the participation and views of key stakeholders and has held two seminars to discuss and develop the proposed airport licences. Dr. Peter Smart, Aberdeen Airport Consultative Committee and Mrs. Paula Street, Gatwick Airport Consultative Committee (and on behalf of the Liaison Group), attended both the seminars to gain a better understanding of the proposed new regime.
 18. The content of the new licences can be broadly clustered into three main categories:
 - (1) Licence conditions which are necessary to provide an effective and operable structure for the new licences. These are conditions which stipulate e.g. definitions, duration, conditions for licence revocation and conditions for the payment of licence fees to the licensing authority. These are likely to apply to both Tier 1 and Tier 2 licences.
 - (2) Conditions which give effect to the current provisions imposed on these airports through the price control settlements and provisions in place to remedy public interest findings made by the *Competition Commission* in past price control reviews. There are also a small number of other provisions imposed on airports through the Airports Act 1986, such as a requirement to include certain additional information in their statutory accounts, which need to be considered for transposition into the new licences. This category applies almost exclusively to Tier 1 licences, with some small exceptions, such as the statutory accounts condition, which also apply to some Tier 2 licences.
 - (3) A number of new licence conditions will result from the DfT’s proposed reforms of the current framework which currently do not apply to airports, including, for Tier 1 licences, financial resilience provisions, licence conditions regarding consultation and information sharing, and for both Tier 1 and Tier 2 licences conditions governing the relationship between the licensed airports and the proposed new passenger representative body, (PF), and conditions giving effect to the provisions set out in the ACD.
 19. The CAA’s current suggested model for the airport licence structure for Tier 1 and Tier 2 airports is illustrated in Annex 2. It should be noted that Tier 2 licences are only proposed to give effect to the provisions of the ACD which applies to those airports handling 5 mppa or more.
 20. CAA explained that the difference between the licence structure initially suggested and that now being proposed was that “collective conditions” would be limited to those which made a licence workable. CAA described the procedure for a collective condition modification as proposed by the DfT. Under this procedure the CAA would propose a change which, if supported by 80% or more of the number of licensees who represented 80% or more of passengers handled at licensed airports, would be treated as an agreed change and this meant that no airport would then be able to trigger an appeal to the CC (although PF or the Secretary of State could still trigger a CC appeal). The CAA would only make a proposal

that it considered to be in accordance with its statutory duties. There would still be recourse to judicial review. The mechanism the CAA was proposing would reduce its power to modify these types of condition.

21. There was much discussion about the appropriateness of a collective licensing regime. The concern was that collective conditions could only be modified in the future with the collective agreement of all the airports that were subject to the licence regime. Stakeholders told the CAA that a collective agreement process was more likely to attract objections to proposed changes, particularly as there would be no right of appeal for individual airports on collective conditions. The power of the larger airports (and airport groups) to veto proposed modifications was an issue of concern to a number of interests represented at the seminar and it was suggested to the CAA that the areas to be covered by collective conditions needed careful consideration. The CAA was of the view that collective conditions would apply to all licensees and that the DfT's proposals envisaged that the Tier 2 licences would only contain conditions which either (a) made the licence operable (b) related to the ACD or possibly (c) other international obligations or those relating to PF. This limited the scope of any new or modified collective licence conditions and the issue was therefore significantly less important than it might otherwise be.
22. The need to include specific licence conditions relating to PF was discussed but as the DfT's proposals for PF were not yet known, it was difficult to develop advice on specific licence conditions. The CAA was of the view that as PF's remit was likely to be broad, the airport licence was an inappropriate tool to address the specific relationship requirements between PF and the airport/airlines. The CAA was urged to keep its options open on this matter until more information was available on the proposed functions and duties of PF. There was a suggestion, however, that a licence condition could require the airport to ensure that PF was represented on its airport consultative committee.

Passenger Focus

23. The former Government decided that PF would gain new functions to represent the interests of air passengers drawing upon the expertise, knowledge and goodwill built up by the AUC. It is proposed that the AUC staff should be integrated with PF. This decision is disappointing as there was much opposition across the industry to this body taking on the national consumer interests role. It also appears that the concerns expressed by the House of Commons Transport Committee⁷ in its first report on *The Future of Aviation* have been disregarded.
24. The Committee concluded:

“We welcome moves to strengthen the voice of air passengers and the increased emphasis on the passenger in the remit for the CAA. It is not clear how the Government's proposal to replace the Air Transport Users Council with Passenger Focus would influence the airlines or airports. This is true despite the proposal to beef up the passenger advocacy role of Passenger Focus, as compared to AUC's current remit. No new powers are proposed. Government influence over bus and rail companies, for example through the specification of rail franchises, does not extend to the aviation sector which is heavily prescribed by international legislation. The air travel market is highly competitive and operators take a hard-nosed approach to service costs and standards. Whatever the Government decides regarding passenger representation, it is essential that the powers of a body defending passengers' rights match its remit. If not, it may create false expectations.”
25. The former Government in reaching its decision noted stakeholders' concerns about PF taking on this new role but advised that its policy had generally been to reduce the number of sector specific consumer representation bodies and move towards multi-sector consumer bodies which can bring a broader perspective. Concern about funding has been addressed and the former Government agreed that the aviation industry should only pay for air passenger representation and that transparent funding mechanisms should be put in place to ensure that no cross subsidy occurs towards the work of PF on rail and bus issues. The

⁷ <http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtran/125/12509.htm>

additional funding needed to support PFs' work on air passenger representation would be reflected in higher airport charges to airlines which in turn should pass through to passengers via airfares. The former Government believed that the advantage of funding air passenger representation via the licence fee is that it would be only the users of the licensed airports who would pay (it is understood that around 90% of total passenger numbers would be handled by licensed airports).

26. It is envisaged that PF would support the CAA and challenge, without duplication, the work of the CAA in its new enhanced consumer policy role. PF would provide consumer input to the CAA's regulatory strategies and decisions, including price control decisions, based on its own research and information gathered from developing insight into passenger experience at airports and from handling passengers' unresolved complaints. The expectation is that PF should work with the CAA to draw up a *Memorandum of Understanding* which would make their respective roles transparent. It also expected PF to build on its regional network of passenger link managers to develop an insight into passenger experience at airports.
27. Delegates will be interested to note that in its response to the DfT, the CAA supported the proposal for developing the consumer representative body in air travel. It believed that passengers would benefit from research into passenger interests and from advice on how the CAA could best deliver benefits for consumers in its regulatory decision making. It welcomed the opportunity to work with the DfT to ensure a clear division of roles between the CAA and the consumer representation body. As regards the funding of the consumer body, the CAA has recommended that the Government should retain responsibility for setting the consumer representation body's budget and for scrutinising the efficiency of the body.
28. As regards the implications at the local level, it would be for PF to decide whether or not to establish a network of consumer panels at leading airports. The DfT has emphasised that it does not envisage a lesser role for passenger representation by airport consultative committees at airports. It will be for PF to determine the best way of drawing on the work of committees in order to avoid any duplication of effort.
29. Further preparatory work is being undertaken to develop and define the specific duties and powers of PF, some of which may need to be reflected in proposed licence conditions, such as the requirement for airports in some circumstances to provide information to PF. Although it is not known how the new Government will wish to take forward this proposal, if it is to be progressed further consultation on PFs' specific duties and powers will be undertaken.
30. As regards timescale for implementation, delegates should note that PF assumed responsibility for buses in April this year, two years after the Secretary of State for Transport announced in April 2008 that its role would be widened to include bus passenger representation.
31. The Government intends consulting further on the duties and powers of PF so early consideration of the implications will better inform airport consultative committees in their response to that consultation. As it has been left to PF to consider whether or not to establish a network of consumer panels at the leading airports, the UKACCS Working Group agreed that it would be advantageous for committees if the DfT, CAA and PF were invited to address the Annual Meeting to initiate discussions to influence proposals on how the new way of working could be achieved to avoid duplication of work. There is a need to set clear lines of communication for passengers, airport operators, airlines and airport consultative committees and to ensure that the voice of airport passengers is taken fully into account in the advice PF gives to the CAA. The three parties have therefore been invited to address delegates on the Wednesday afternoon which will enable the Liaison Group to consider the implications for their committees, share ideas and to suggest ways forward. Delegates are therefore asked to give some thought to this prior to the meeting as it is important that the DfT, CAA and PF gain a clear understanding of the member committees' existing work on passenger issues and the role and work of committees' passenger services sub-committees/groups.

Review of Guidelines for Airport Consultative Committees

32. The DfT is currently reviewing its guidance to airport consultative committees to reflect the current comprehensive scope of the committees' activities and the DfT will consider how this might be used to facilitate cooperation between the committees and PF e.g. whether PF should be represented on the consultative committees. The DfT initiated discussions on aspects of the current guidelines which would benefit from revision/enhancement at the meeting of the UKACCS Working Group on 26th January. The views of the Working Group were:

- *Scope and Role of ACCs* - There was a unanimous view that ACCs were “consultative” forums and it was vital therefore that the guidelines remained flexible and non-prescriptive so that they could be applied at individual airports to reflect local circumstances. There were cases where the public and lobby groups regarded the guidelines as the constitution for ACCs and it was felt that the reviewed guidelines should clearly state that they did not form part of the constitution of a committee. Members also commented that there were instances where certain interests serving on a committee had sought to use the committee as a lobby forum. It was felt, however, that one of the roles of the Chairman was to ensure that there was a balanced debate at meetings.
- *Definitions* – the need to define the term “users of the aerodrome” was considered as it had been suggested to the DfT that there would be benefit in clarifying what the term covered. It was acknowledged that there was no direct reference to passengers in the current guidelines or other interests such as retail or aircraft operators. It was agreed that some clarity was needed but any revision to the term should not be too prescriptive so as to allow flexibility.
- *Membership* – the Working Group believed that the Chairman should be independent of any interest group serving on the committee as it was important to give public confidence in the effectiveness of the committee. It was noted that some committees at smaller aerodromes had locally agreed arrangements where the aerodrome’s Managing Director or another member of the committee was elected chairman. Whilst it was most desirable to have an independent chairman, it was felt that if local agreements were in place which had the full support of the committee then this should not be prevented. The Working Group suggested however that greater guidance on the selection process for the appointment of the Chairman should be given in the reviewed guidelines.
- *Secretary and Secretariat* – the different practices for the provision of a committee secretary and secretariat was acknowledged. Ideally the secretariat should be independent of the airport and have the expertise and knowledge to help guide the committee. The key issue however lay in the funding of the secretariat. It was felt that airport operators should be responsible for ensuring that the secretariat was properly resourced and funded.
- *Technical Advice* – it was agreed that there was a need to ensure that committees had access to independent technical advice as and when needed funded by the airport operator. This was considered important as committees were increasingly being involved in more technical issues, e.g. noise action planning where independent technical advice would be beneficial.
- *Public Participation* – the differences among committees on the approach to allow public participation in committee meetings were acknowledged. It was generally felt that the guidelines should not be prescriptive and that it should be left to individual committees to decide how they wished to involve the public in the topics debated by committees. Of greatest importance was the need for committee meetings to be open to the public and press to observe proceedings and for the minutes and supporting papers to be publicly available. It was highlighted that a only a few committees had a website and it was felt that the guidance could be updated to reflect the way in which new technology could be used to disseminate information to the wider audience. It was also felt that there was a collective responsibility on members of committees to

disseminate information and the decisions of their committee to the wider community. The guidelines needed to provide further guidance on this aspect.

- *Complaints* – it was acknowledged that complaints handling (passenger and noise related) by committees varied – some looked at individual complaints while others looked at trends. Reference was made to the Government’s decision to give passenger complaints handling to PF and it was questioned how this would impact on the current work of committees. There was a need for the guidelines to be reviewed to clarify the role of airport consultative committees in terms of passenger complaints.

33. Frank Evans, DfT, will provide an update on the review at the meeting.

Paula Street
Liaison Group Secretariat
May 2010

ANNEX 1

REFORMING THE FRAMEWORK FOR THE ECONOMIC REGULATION OF AIRPORTS: DECISION DOCUMENT

EXECUTIVE SUMMARY

Context to reforming the economic regulation of airports

- 1.1 The Government issued a Consultation in March 2009 on its proposals to update and reform the framework for the economic regulation of the airports sector in Great Britain⁸. Following consideration of responses to its Consultation, the Government announces a package of reforms designed to modernise the airport economic regulatory regime and put the passenger at its heart. This decision document sets out those reforms and their rationale.
- 1.2 The current regulatory regime for airports was established over 20 years ago in the Airports Act 1986. Since then, there have been a number of developments in the sector, not least the liberalisation of air services and the resulting growth of competition between airports. There have also been developments in our understanding and execution of utility regulation, that has resulted in major changes to the statutory framework for other major regulated sectors in the UK.
- 1.3 In recognition of this, the Secretary of State for Transport announced a review of the framework of economic regulation of airports, in April 2008. In a written statement to Parliament the Secretary of State outlined the following key policy objectives of the Review:
 - Improving the passenger experience;
 - Encouraging appropriate and timely investment in additional capacity to help deliver economic growth in line with Government policy; and
 - Addressing the wider environmental impacts from airport development.
- 1.4 The Secretary of State also stated that *“if legislation is required as a result of this work, it would be taken forward in a future legislative session. Therefore we will not make changes to the basis on which the current price caps at Heathrow and Gatwick airports are set. This also applies to the cap which will take effect at Stansted from 1 April 2009”*.⁹

⁸ We are discussing with the Devolved Administrations the applicability of these proposals to Northern Ireland.

⁹ The provisions of the Airport Charges Directive (ACD) will nevertheless need to be applied to all airports from 2011.

- 1.5 Placing the interests of consumers at the centre of the regulatory framework in those sectors of the economy that have independent economic regulators has been a consistent theme of regulatory reform over the last 10 years in the UK. This approach recognises that in competitive markets meeting the interests of consumers drives the actions of service providers. Economic regulation is intended as a substitute for strong competitive pressures in sectors where companies have substantial market power (and where regulatory intervention is warranted).¹⁰ In these circumstances we believe that the key focus of economic regulators should be to promote and protect consumers' interests. The Government is therefore seeking to put passengers at the centre of the new regulatory framework for airports through: a new primary duty for the economic regulator – the Civil Aviation Authority (CAA) – to promote the interests of passengers;¹¹ enhanced passenger representation through the new role for Passenger Focus¹² in the aviation sector; and new rights of appeal for the passenger representative.
- 1.6 The promotion of passengers' interests will generally be best achieved through the promotion of competition between airports, and this is reflected in the CAA's new primary duty. However, for the foreseeable future there are likely to remain airports that have substantial market power or dominance and for which it remains appropriate to continue economic regulation. The new licensing regime will allow the CAA to tailor regulation to best meet the particular circumstances of such airports, ranging from price caps to price surveillance. The new sanctions regime, similar to that in other regulated sectors, will also help the CAA to seek to ensure that licence conditions are complied with. As part of the new licensing regime the proposals will give long-term effect to elements of the EU Airport Charges Directive (ACD) through licences for all airports with more than 5 million passengers.
- 1.7 Investment in new and improved facilities is likely to remain a key way in which airports can better meet passengers' requirements. These decisions should further improve the climate for investment by moving the regulatory regime closer to understood best practice from other sectors. As such the reforms include new provisions to promote financial resilience of major airports.
- 1.8 In light of the environmental objective for the Review, the Government will introduce a supplementary duty on the environment to seek to ensure that economic regulation takes place in a way that is consistent with the variety of legally enforceable environmental obligations airports are subject to. Going further than this and using economic regulation as a means of addressing the environmental externalities associated with airport development risks distorting competition. This is because, in discharging its economic regulation of airport functions, the CAA can only directly influence airport conduct at airports with substantial market power where regulatory intervention is required (currently Heathrow, Gatwick and Stansted). However, the CAA's other regulatory functions impact on industry in a more uniform way so that such problems do not arise. Therefore, we are consulting separately, on a proposal to apply a general objective to the CAA (which would not apply to the CAA's airport economic regulation functions) that would require the CAA, where possible and appropriate, to have regard to environmental factors and seek environmental improvements when discharging other regulatory functions. This proposal can be found in 'Regulating Air Transport: a Consultation on proposals to update the Civil Aviation Regulatory Framework'.
- 1.9 A key part of the new regulatory regime, alongside the reforms to the CAA's governance

¹⁰ The phrase 'where an airport has substantial market power and where regulatory intervention is warranted' is used as short hand throughout this document for an airport which meets the three criteria for a tier 1 licence. For more information on these criteria, see Chapter 4.

¹¹ Throughout this document the word passengers is used as shorthand for end users of airport services.

¹² Passenger Focus is officially known as the Rail Passenger's Council.

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

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

Reforms to the economic regulation of airports

Reforming the statutory duties of the economic regulator

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

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

1.12 The supplementary duties will require the CAA:

- i. *“to have regard to the airport operator’s legal obligations to comply with applicable environmental and planning law;”*
- ii. *“to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently;”*
- iii. *“to ensure that licence holders are able to finance the activities which are subject to the relevant licence obligations;”*
- iv. *“to have regard to guidance issued by the Secretary of State, as well as any National Policy Statement on airports;” and*
- v. *“to have regard to the principles of Better Regulation and to consult with stakeholders, including airlines”.*

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

Introducing a new licence regime

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

- o Introduce a two tier licensing structure. Airports in Tier 1 will be those with substantial market power where regulatory intervention is warranted, while those in Tier 2 will be all other airports meeting the 5 million passengers a year threshold in the Airport Charges Directive (ACD). Currently, apart from provisions necessary to ensure that the licence is effective, such as a revocation condition, the DfT is anticipating that the Tier 2 licences will only include provisions directly related to the ACD.
- o Introduce primary legislation based on the current designation/de-designation criteria to determine whether an airport has a Tier 1 licence. The appeal mechanism for the CAA's decision about whether an airport should have a Tier 1 licence is discussed in Chapter 6.
- o Seek advice under Section 16 of the Civil Aviation Act 1982 from the CAA regarding the drafting of some licence conditions. This advice will be taken into account by the

Secretary of State in formulating draft licence conditions to be published for consultation. Following consultation, the Secretary of State would be responsible for deciding upon the precise content of and issuing the initial licences.

- Give the CAA sanctions and enforcement powers for breach of licences similar to the powers held by other economic regulators in the UK. This includes the use of enforcement orders to incentivise compliance with licence conditions. The CAA will be required to develop and publish an enforcement policy.
- Give the CAA powers to impose financial penalties for the breach of licence conditions up to a maximum of 10% of the annual turnover of the regulated business.
- Give the CAA concurrency competition law enforcement powers for services provided by airport operators. We are separately consulting¹³ on giving the CAA additional concurrent power, which would cover services provided at the airport by parties other than the airport operator.
- Introduce provisions which enable airports to retain their status as statutory undertakers.

Promoting financial resilience

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

- A supplementary financing duty for the CAA that is similar to the financing duty many other UK economic regulators have.
- A minimum credit worthiness requirement for Tier 1 airports.
- Ring fencing provisions similar to those in place in the energy, water and rail sectors for Tier 1 airports. There will be initial derogations for some of these ring fencing provisions because the costs of introducing those provisions currently exceed their benefits.
- We have decided that the benefits of Special Administration are not sufficient to support its introduction.

1.16 The Government will also be consulting on:

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

Enhancing Accountability

1.17 We recognise the importance of having strong checks and balances on the CAA to ensure high quality decision making, so we have decided that:

- The Competition Appeal Tribunal (CAT) should be the body that considers appeals regarding Tier 1 licence decisions, and the appeal should be an adjudicative appeal. The licence holder or potential licence holders and all other parties with a material interest (which will be determined by the CAT) should have a right to appeal. The Secretary of State will also have the right to refer a Tier 1 decision to the CAT.
- Licence modification determinations by the CAA will be subject to a right of appeal to the Competition Commission by way of an investigative procedure. Licence holders,

¹³ Regulating Air Transport: Consultation on proposals to update the regulatory framework for aviation. December 2009
<http://www.dft.gov.uk/consultations/open/regulatingairtransport>

as well as the Secretary of State and Passenger Focus as the passenger representative body for passengers' interests will have the right to challenge CAA proposed licence modifications and determinations.

- Licence conditions giving effect to the Airport Charges Directive (ACD) may only be modified by the Secretary of State.
- The CAA will be required like most other economic regulators to include relevant information in its annual report, annual accounts, and its forward-looking corporate plan.

Enhancing passenger representation

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

Aligning airport services with passengers' needs

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

- To help ensure that Tier 1 airports' expenditure programmes are better linked to passengers' needs, the CAA should build on the process of Constructive Engagement through enhanced information and consultation provisions in licence conditions. These conditions will build on the requirements of the ACD (the provisions of which will also be applicable to Tier 2 airports).
- The CAA should be encouraged to consider whether wider service quality measures would be appropriate to improve the overall passenger experience.
- Inter-terminal competition should not be precluded under the new regulatory regime, if and where the CAA considers that it will bring benefits to passengers.

Endorsing governance changes

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

Next steps

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

for legislation that the Secretary of State will place before Parliament.

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

Licence structure – proposed model

