



Report by the Technical Adviser

Agenda Item:	Reference: HACC.489
Date: May 11 2007	
Airport Regulation - Price Control Review by the Civil Aviation Authority	

## **BACKGROUND**

1. At it's meeting on February 7 2007, the Committee considered a report (HACC.479) about the Civil Authority's consultation on its initial proposals for price control of the BAA London Airports. A response incorporating the views expressed by Members was sent to the Authority on February 16.

2. The Authority has now concluded its consideration of the responses it received, has finalised it's proposals and forwarded them to the Competition Commission for consideration and report back before the Authority makes a final decision. The Committee can expect another opportunity to be consulted before that final decision is made.

3. The Authority says that having weighed up the responses to the consultation, the recommendations it has made to the Competition Commission are very similar to the initial proposals. The main changes made include a downward revision to projections of operating costs, reflecting further scrutiny by the CAA of a number of cost elements.

4. The CAA recommends that indicative ranges for the maximum rate of increase in airport charges as set out in its initial proposal i.e Retail Price Index +4% to RPI +8% at Heathrow and RPI – 2% to RPI+2% at Gatwick, be adopted.

5. The Authority points out that there is almost a year before it takes a final decision on price controls and that a number of matters are still subject to further analysis and consultation with the interested parties so that a view has not been taken on what the price controls should be.

6.The Executive Summary of the Recommendations is attached at the Appendix as an aid to Members consideration.

## **THE SUMMARY**

7. Para.5 of the Summary emphasises the need for air passengers to be better served through a greater focus on delivery of the service quality and facilities to meet future needs, with regulatory incentives designed to encourage such outcomes. It also proposes that regulation should be tailored to each airport and that each should continue to be separately regulated.

8. There is particular emphasis on the need to improve passenger's experience of security processing, something which is apparent from the complaints which the Committee is receiving from passengers.

## Changes in BAA's ownership and financial structure

9. In para.6, the Authority draws attention to the 2006 changes in ownership and financial structure of BAA Plc which have resulted in the airport operator taking on greater financial risks and states that it proposes to prevent such risks being transferred to users through a number of measures.

## Traffic Forecasts

10. Para.7 draws attention to a number of outstanding issues on which it would be premature to draw definite conclusions at this stage. These include:

- (a) traffic forecasts at both Heathrow and Gatwick which will need to be re-assessed, in particular because of the recent "Open Skies" air services agreement between the EU and US allowing more trans-Atlantic carriers to operate from Heathrow
- (b) future runway capacity at Heathrow which will be influenced by the outcome of the forthcoming Government consultation, expected later in 2007, on the potential expansion of the airport's capacity limits

11. These forecasts are, however, accompanied by a warning in the text of the Recommendations that if the EU/US Air Transport Agreement was signed, it might add as much as 1 million passengers to Heathrow volumes whilst reducing volumes at Gatwick by as much as 0.5 million passengers annually.

12. In its January response to this consultation, BAA submitted revised passenger traffic forecasts for the period to 2017/18 for Heathrow Airport. These indicated reductions in volume of some 2 million passengers each year of the total throughput in the forecasts compared to the earlier forecast made in September 2006. In 2005/06 there were 67.4 million passengers. It is forecast that in 2008/09 there will be 69.7 million rising to 76.2 million in 2012/13 and 84.4 million in 2017/18.

13. BAA explains that the reduction in the forecasts is due to an expectation of lower passenger loads per aircraft than had been predicted.

## Passenger Charges

14. Para.9 records that the current price cap would allow airport charges to rise to £9.05 per passenger in 2007/08. If the Authority's proposals are implemented, the passenger charge would reach £12.50 by 2012/13. This compares with BAA's proposals which would have taken the airport passenger charge to £17.00 in 2012/13.

## **THE TEXT OF THE RECOMMENDATIONS**

### Conditions

15. CAA refers to the consultation which it undertook in October 2006 about the continuance of a number of Public Service Conditions laid upon BAA Heathrow. The HACC considered this consultation at its meeting in December 2006 and informed the CAA that it advocated the retention of all of the existing conditions. The Authority now says that it expects to publish any proposals to modify the conditions later this Spring.

### Environmental Policy

16. Under this heading, the Authority deals with the increases in Air Passenger Duty and the Government's Pre-Budget Report which noted the role that it could play in tackling the climate change impact of aviation. The CAA refers to the EU proposal for a Directive requiring aviation to enter the EU Emissions Trading Scheme and concludes that it is likely

that air passengers and cargo shippers will face additional costs from attempts to mitigate the contribution of aviation to global warming.

17. Both the HACC and the Gatwick Airport Consultative Committee responses to the consultation had criticised the lack of environmental awareness in the Authority's proposals and this current document explains why that is.

#### Air Transport Policy

18. Members will be particularly interested to read the Authority's summing up of the situation regarding proposals for expanding Heathrow resulting from the Air Transport White Paper Progress Report which says, in para. 2.15 of the text of the Recommendations, " for Heathrow, the DfT is planning for a full public consultation on its future development during 2007, once the environmental assessment work is complete. The consultation will describe the mixed mode and third runway proposals in detail and report on the predicted impacts of development, in particular against the noise and air quality limits. It will also seek views on the appropriateness of current operational practices driven by the Cranford Agreement, runway alternation and Westerly Preference. Policy conclusions on the future development of Heathrow could not be reached until the end of 2007. Following this, any development proposals would need to be subject to further detailed design work and the preparation by BAA of planning applications"

#### Reforms to Airport Policing

19. The Civil Aviation Act 2006 introduced new provisions for the assessment and funding of policing at, amongst others, Heathrow Airport. As a result, there should be a " police services agreement" in force by November 2007 to cover the level of policing, payments to be made by the airport for that policing and accommodation and the facilities to be provided. The Home Office and DfT are leading a programme of work to identify the appropriate level of policing for such an agreement. The CAA will take into account any evidence on future police costs which may arise from this.

20. Members may recall the publicity in 2006, which was given to remarks by the then Superintendent of the Metropolitan Police at Heathrow of a significant shortfall in the level of payment made by BAA compared to the costs being incurred.

#### Airline Views

21. Views expressed by the airlines who responded to the consultation are reported in some detail. British Airways highlighted that the expansion of Heathrow in particular was essential to its future profitable growth and competitiveness against other airlines operating from less congested hubs and it supported investment in major expansion there. BMI said that regulation needed to deliver competitive prices consistent with cost-effective systems whilst easyJet commented on the shift in growth from South East England airports to those in the rest of the UK's regions because demand is being choked off by a lack of supply, particularly at Heathrow and Gatwick. easyJet also welcomed the stance adopted by CAA to protect users' reasonable interests in terms of price, service quality and provision of facilities and airport capacity following the acquisition of BAA by the consortium led by Grupo Ferrovial.

22. Virgin Atlantic noted that the performance of Heathrow in particular, was vital to the continued competitiveness of London and inefficient operation of the airport was a threat to the UK's economic performance.

## The HACC Views

23. The views submitted by this Committee are summarised as :

“ The Heathrow Airport Consultative Committee commented that the CAA's initial proposals did not show awareness of the significant costs to BAA at Heathrow for dealing with environmental matters. The HACC considered that Heathrow Airport should be in a position to fund fully existing noise mitigation and blight compensation schemes. It also noted that Government consultations on the potential expansion of Heathrow, anticipated in the summer of 2007, could extend well into the Q5 (*next*) price control period, and that the HACC would wish to review these issues before the CAA makes any price control provisions for the costs of any Heathrow expansion. The HACC also noted that there could be a significant increase in the operational cost of policing at the airport.”

## Service Quality

24. The Authority's recommendations deals extensively with the need to improve service quality and the rebates payable by BAA where agreed standards are not met and it highlights concerns about pier service in Heathrow Terminal 4. The Authority suggested that a standard for central security queuing should provide that queues should not exceed five minutes, something BAA has announced recently that it is adopting. It also considers that Transfer Security Queuing and Control Post Queuing should be included in the scheme, both matters the PSSC has been concerned about. The Heathrow airlines have proposed that the targets for cleanliness, way finding and flight information should be increased and they are considering BAA's proposed cost increments to achieve these service quality improvements. There are other discussions progressing about improving availability of pier service and transfer coaching in the context of the Constructive Engagement process between the airport and airlines about which the HACC is consulted.

25. As the process of consideration by the Competition Commission and the CAA progresses during 2007, there will undoubtedly be other matters which the HACC will be considering which will influence its views about the this Price Control Review. There will be further opportunities for Members to consider and to comment about the later proposals by those organisations before any final decision is taken.