

Economic regulation: A review of Gatwick Airport Limited's commitments framework

GAL'S RESPONSE TO CAA CONSULTATION CAP 1387

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Purpose

This paper provides the response from Gatwick Airport Limited (GAL) to the CAA's consultation on the proposed scope of the forthcoming review of GAL's regulatory framework.

Summary

- GAL agrees with the overarching aim of the review "to identify any aspect of the new framework that is acting against the interests of passengers".
- GAL considers that the CAA should clearly identify the performance of the new framework against the outcomes which might have been anticipated to have been delivered under the former more traditional price cap regime. Without such a clear benchmark, there is a risk that the CAA may assess current performance against a hypothetical and unrealistic alternative.
- GAL considers that the CAA could also use the review to identify aspects of the new framework which are working well for passengers, and thereby update its own assessment of the actual benefits which this form of regulation can deliver.
- GAL agrees that on time performance is an important aspect of service delivery to passengers, and one where outcomes have fallen short of targets for performance in recent years. GAL is playing a leading role in seeking solutions to improve punctuality. We are working hard across a range of activities (operational planning and delivery, investment, financial incentives) and in collaboration with airlines, ground handlers, air traffic control and slot coordinators, to enable airlines to achieve higher levels of punctuality at Gatwick.
- As the CAA has recognised, on time performance is the outcome of a complex system involving aircraft, airspace, airfield and terminal infrastructure and the coordinated operational activities of airlines, airport, ground handlers and other agencies. As such, performance shortfalls in this system are the result of the actions of multiple organisations. The CAA's economic regulatory framework for Gatwick is just a small factor within the overall system which delivers the capacity and service outcomes for passengers. The CAA should recognise this much wider context in its review of GAL's regulatory framework.

1. Economic regulation of GAL

We have no particular comments on the CAA's description of the background to, and the outcomes from, the most recent regulatory settlement (Q6) at Gatwick.

With regard to monitoring GAL's Commitments, we consider that passengers' interests are comprehensively protected through the consultation mechanisms and sharing of information which Gatwick undertakes on a regular basis. These include:

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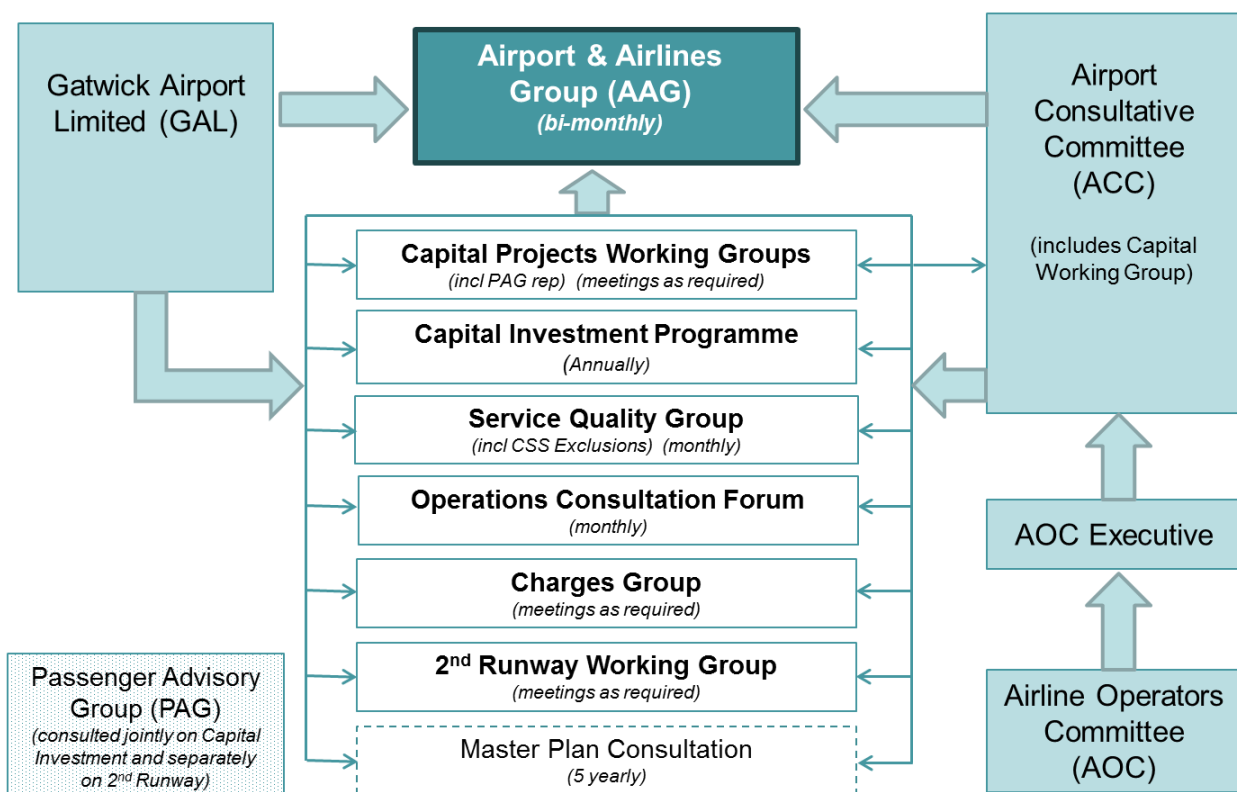
Gatwick

- Airport performance: bi-monthly consultation with airlines and passenger representatives which includes full briefing on GAL's operational and service performance
- Charges: Full consultation on an annual basis on the structure and level of airport charges, in compliance with the Airport Charges Regulations
- Investment: cycle of consultation on the Capital Investment Programme, involving airlines and passenger representatives, with opportunities for users to input their respective investment priorities as well as review GAL's proposed plans and look back at investment performance in the previous financial year
- Operations: monthly consultation via the Operations Consultation Forum (since autumn 2015) with airlines and passenger representatives on Gatwick's current portfolio of operational projects and initiatives which require some user input
- Operational resilience: bi-annual consultation with airlines, passenger groups and other stakeholders on GAL's processes and plans to deliver a resilient service outcome.

The structure of GAL's consultation architecture is shown in Figure 1 below.

Figure 1

Gatwick Airport Consultative Structure



We would encourage the CAA to recognise that regulatory monitoring of GAL's performance takes place in the broader context of the multi-dimensional consultation and information which we provide to passengers and airlines under the Commitments framework.

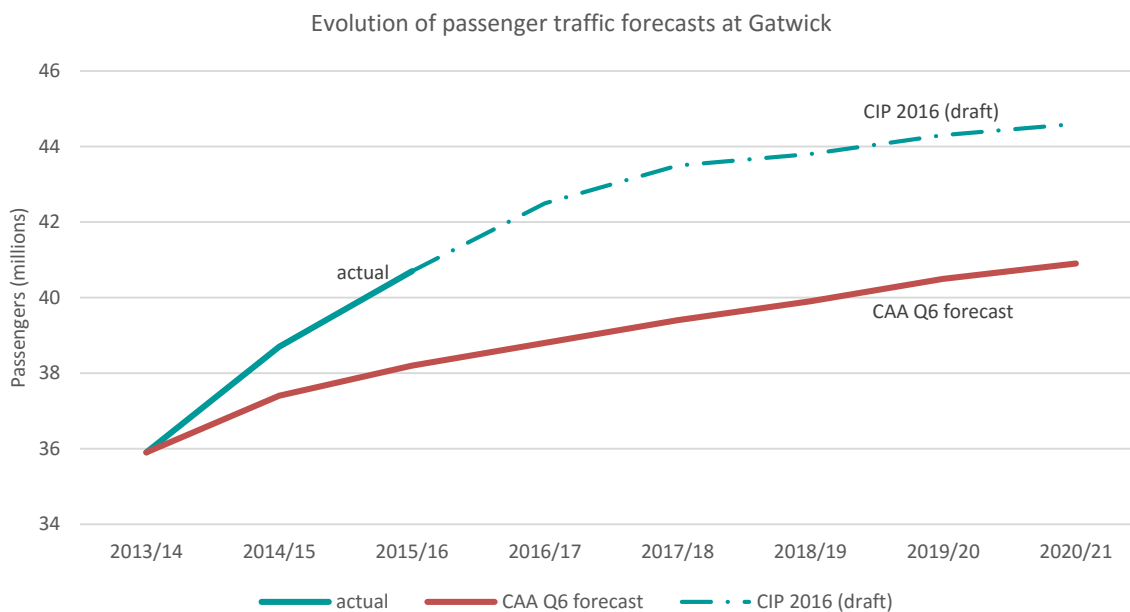
2. Summary of recent developments

The evidence presented by the CAA in its consultation paper provides a high level overview of some of the performance indicators for Gatwick and, where relevant, other London-area airports. In conducting the review itself, we would encourage the CAA to draw on other publicly available evidence on Gatwick's performance, notably the forthcoming report by the Competition & Markets Authority on the outcome of the Competition Commission's report on BAA. We have provided to the CAA and published the report which GAL commissioned from consultants Oxera to inform the CMA's assessment¹.

2.1. Traffic

The CAA is correct to highlight stronger than expected growth in traffic at Gatwick as an important aspect of recent developments at the airport, and an important driver of future investment and service delivery planning. In 2015/16, Gatwick handled 40.8 million passengers. For the purposes of its capital investment planning, GAL is currently adopting a forecast of 42.5 million passengers in 2016/17, growing to 44.6 million by 2020/21, as shown in Figure 2 below.

Figure 2



2.2. Investment

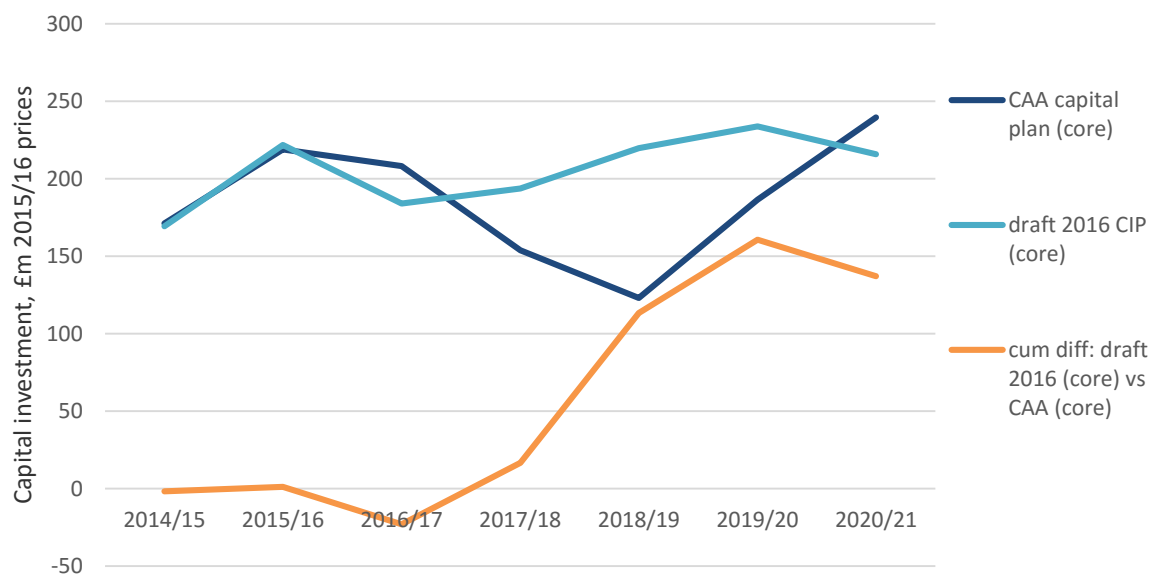
In response to recent achieved traffic growth and in anticipation of sustained higher growth through to 2020 and beyond, GAL has recently updated its investment plans. As the CAA highlights, our latest plans entail significantly higher annual average expenditure to 2020/21 than was anticipated in early 2014 when the licence was set. We are currently projecting² that capital investment will total £1.60 billion in the seven year period 2014/15 to 2020/21, some £152m (11%) higher than the

¹ [Evaluation of the Competition Commission's BAA airports market investigation, Oxera report for GAL, January 2016](#)

² In the draft 2016 Capital Investment Programme, subject to consultation with users until early May 2016. All prices in 2015/16 price base.

CAA's forecast for this period, made as part of the Q6 price review. In terms of the core capital expenditure³ category, on which the CAA based its 'fair price' benchmark calculation, GAL's current proposed core programme would deliver £1.44bn, some £137m (11%) higher than the CAA's core capital investment forecast. This is highlighted in Figure 3 below.

Figure 3



2.3. Airport charges

As the CAA highlights, GAL is currently pricing some way below the CAA's 'fair price' benchmark of RPI inflation – 1.6% for the average annual increases in the blended price per passenger⁴ over the course of the Commitments period. In addition to setting charges for three financial years under the Commitments framework, GAL has also provided forward guidance to airlines regarding the trajectory of airport charges in future. In its January 2016 decision on charges for 2016/17, GAL also stated that:

“GAL currently anticipates that the increase in the Planned Gross Yield in 2017/18 will be at a similar level to the increase in 2016/17. However, it should be noted that no decision has yet been made and that GAL's proposal will be subject to formal consultation during next year's airport charges consultation process.”

2.4. Service quality

Gatwick's central goal is to deliver a consistently high level of service to passengers and airlines. Through concerted management and staff action, underpinned by capital investment and operational reforms, we have delivered improved outcomes since 2010. In the most recent year 2015/16, we have achieved a success rate of 95.2% against our Core Service Standards⁵, with temporary reductions in service delivery (now restored) attributed mainly to the introduction of new passenger security infrastructure and processes in South Terminal and to the later than scheduled

³ excluding projects in the development category

⁴ including the effect of contractual discounts to tariff

⁵ For the months April 2015 to February 2016. There are 40 metrics measured each month under the CSS scheme; 11 fails against target during this period equates to fail rate of 4.8%.

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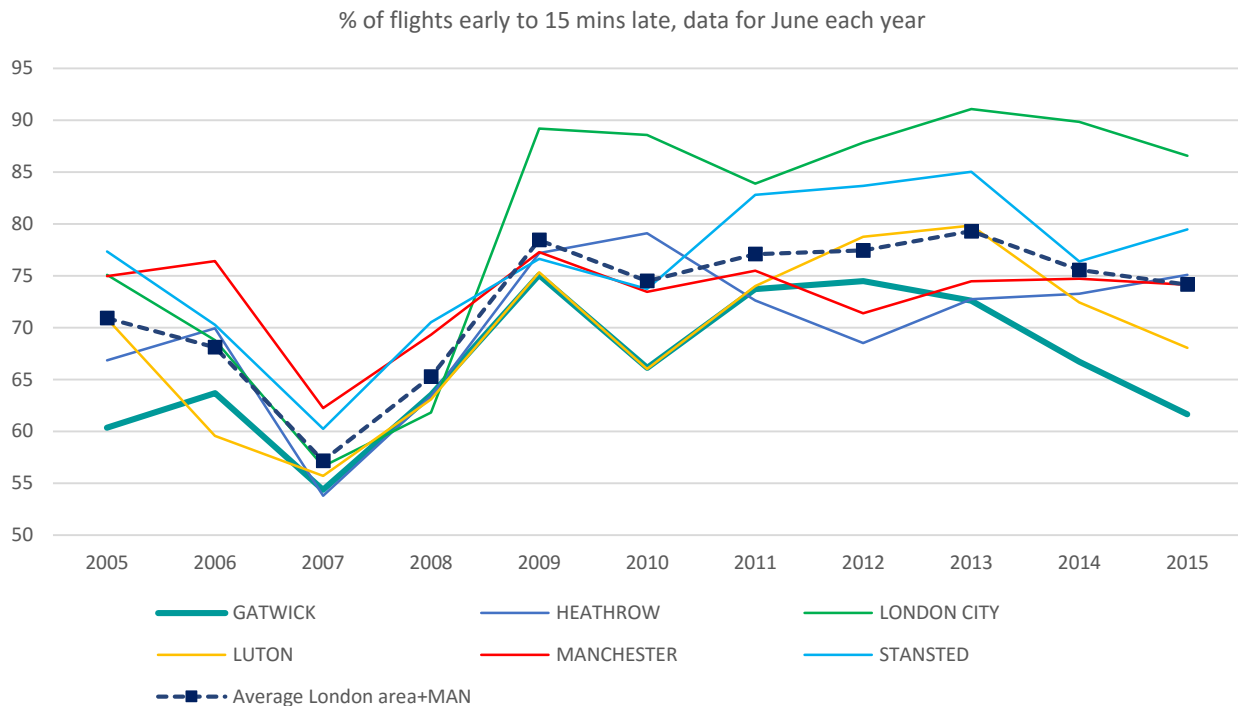
Gatwick

delivery of airfield infrastructure which provides services to airlines. The comparable success rate in 2014/15 was 98%.

The CAA highlights the relative decline in on time performance at Gatwick in recent years, but also notes that this metric is not included in the Core Service Standards, in part because it is affected by a number of different parties, including the airport operator, airlines, ground handlers and air traffic control. We would note at this stage that over the past few years, the ability of airlines using Gatwick airport to operate on time has faced challenges. This has been exacerbated in recent years by increasing UK and European airspace congestion as well as by recurring staffing shortages by ground handling agents. Achieving sustainably high levels of punctuality at Gatwick has thus been a long-standing and deep-rooted systemic challenge. It is part of the wider issue of aviation infrastructure and capacity in the South East which the CAA and Government has considered over many years. This is illustrated in Figure 4 below, which highlights punctuality for a typical summer month at London airports plus Manchester over the past decade (using CAA published data). Gatwick's relative performance has been consistently in the lower half of this group. This is as a result of underlying factors such as proximity to continental European airspace, the composition of traffic (primarily holiday flights in summer, with a greater focus on ensuring the aircraft leaves with the full complement of passengers at the potential expense of punctuality), and the high levels of utilisation of Gatwick's airfield and terminal facilities.

It is apparent that trends in Gatwick's punctuality largely follow those of other London area airports; since 2013, London City, Stansted and Luton have all experienced declines in punctuality performance, albeit to a lesser degree than Gatwick. Some 70% of the change in Gatwick's punctuality, year on year, is explained by changes in the average for London area airports (less Gatwick) plus Manchester. This suggests that the root causes of the levels and changes in punctuality at Gatwick go beyond factors which are specific to this airport, and therefore that potential solutions to improve on time performance would be found well beyond the realm of economic regulation of Gatwick.

Figure 4



With regard to the causes of reduced on time performance, the CAA ascribes certain explanations to GAL, in contrast to reasons advanced by some airlines. We would suggest that this contrasting of positions may hinder productive joint working to achieve solutions which would deliver better service outcomes for passengers. It is precisely to encourage shared understanding of the on-time challenge that Gatwick has involved airlines in extensive recent efforts to understand and deal with this challenge.

In May 2015, Gatwick initiated an independent review, undertaken by consultants Helios and overseen by a project board including ACL, British Airways and easyJet. The purpose of the study was to understand the underlying reasons for the decrease in on-time departure performance at Gatwick. The analysis used available data through summer 2014 and considered all potential causes of performance loss before focusing on specific agreed areas that appeared to warrant more in-depth analysis. The study concluded in August 2015.

The key findings of the study quantified the importance of on time departures in the first wave and good adherence to turnaround times throughout the day as the leading factors affecting overall on time performance of all airlines at Gatwick. The study also highlighted the adverse impact on punctuality as a whole of late in-bound flights and aircraft experiencing technical issues which stay on stand beyond their timetabled slot. Beyond the airport, the study concluded that European airspace is becoming more congested, in part due to ATC strikes as well as to weekend restrictions. There was no data available to indicate that airlines were building in operational resilience to their rotational block times.

GAL initiated a programme of activities (Chronos I) during summer 2015 to work, with airlines and ground handlers as appropriate, to tackle a number of the identified operational issues which affected airline punctuality.

GAL is currently undertaking a follow-up study by consultants Helios to understand punctuality performance in summer 2015, again involving airlines to help focus the analysis.

The CAA may wish to consider the outcome of this joint working and analysis by GAL and airlines to inform its review of the economic regulatory framework and, more broadly, its work on network resilience of the UK aviation system.

Finally, GAL considers it important that analysis of on-time performance at the airport and across the London area more widely should be based upon the best available data which reflects as accurately as possible the experience of passengers and airlines using the airport. To that end, we have been engaged in recent months with CAA statistical experts on proposals to measure departure punctuality by actual departure from gate time, and in the immediate near term to move to a more accurate measure of taxi time which is used in the CAA's punctuality measure based on take-off time. We would encourage the CAA to update its approach to measuring on-time departures this summer, so that the conclusions from the CAA's review of Gatwick regulatory framework, and its broader project on network resilience, can be based on the best available data.

3. Proposed scope of CAA mid-term review

3.1. Introduction

We agree that the CAA's proposed review should represent an early 'health check' on a new regulatory framework, rather than a reopening of the conclusions the CAA reached during the Q6 review.

We also agree that the CAA's main aim should be to identify any aspect of the new framework that is acting against the interests of passengers. However, given the opportunity that the review provides for the CAA to gather both evidence and the views of stakeholders, we consider that the CAA could also use the review to identify aspects of the new framework which are working well for passengers. The same process that the CAA would undertake to reach a 'no identified concern' conclusion could also generate evidence about positive aspects of the current regulatory regime, over and above what might have been delivered under the previous RAB-based price control and beyond the expectations of the CAA. The CAA could thereby update its own assessment of the actual benefits which this form of regulation can deliver. We would encourage the CAA to take this opportunity.

3.2. GAL's service quality and airport resilience

With regard to the Core Service Standards, GAL has been engaging in recent months with the CAA's auditors on the measurement and reporting of service standards and the accuracy and reliability of rebate calculations. We look forward to the results of this scrutiny and to discussing with the CAA conclusions and any recommendations for action.

With regards to on time performance of airlines operating at Gatwick, as noted above, this is a significantly broader and more long standing issue than could reasonably be encompassed by the CAA's focused 'health check' on the new regulatory regime. The CAA notes that on-time performance at the airport is important for passengers, but it can be significantly affected by the actions of other parties (including airlines, ground handlers and air traffic control). Clearly the primary responsibility for the punctuality of their flights rests with airlines, with the airport playing an important supporting and coordinating role in providing the infrastructure, services and cross-airport planning necessary to enable airlines to achieve their schedules.

It is therefore appropriate that on-time performance is not included in the Core Service Standards. This has been the situation for as long as Gatwick has been subject to regulatory service standards (from the start of the Q4 price control period in 2003), and (by definition) in the prior period when Gatwick was subject only to controls on price and not on service. So the CAA's statement that: "GAL does not face an explicit financial incentive to improve punctuality" has been true (in a regulatory sense) since Gatwick was first subject to economic regulation, as part of the privatised BAA, in 1987. Therefore, we would suggest the new regulatory framework is relevant to the issue of on-time performance only insofar as that framework affects, or could affect, punctuality outcomes.

GAL's role in enabling airport-wide on-time performance is an important one, on which we are judged publicly by our own and CAA's performance data. We are investing GAL's resources in a range of operational initiatives designed to enable ground handlers and airlines to achieve their schedules. This is one clear indicator of the commercial financial incentives which GAL faces to improve punctuality.

Analysis of this systemic issue could be better placed in the wider context of the CAA's work on the impact of congestion on punctuality at major UK airports and how this affects passengers. GAL is supportive of this work by the CAA to understand root causes of delay across the most congested areas of the UK aviation system. We have already shared with the CAA our own assessment of on time performance at Gatwick and explanation of the work that we are leading with airlines, ground handlers and others to deliver better outcomes for passengers⁶. We would be happy to participate actively in consultation and joint working which the CAA may be planning in this area.

3.3. GAL's investment performance

We support the CAA's focus on our investment performance as part of the review of the regulatory framework. We have already provided initial briefing to the CAA on our latest capital plans and on how we engage with passengers to understand their views and feed that information into our development planning⁷.

Under the Contracts and Commitments framework, we consider that we now have the right balance of regulatory and contractual obligations and commercial flexibility to respond to changing circumstances. Together, this enables and incentivises us to deliver infrastructure in a timely, efficient and flexible manner. The draft 2016 Capital Investment Programme (currently subject to consultation with passenger representatives and airlines) demonstrates the benefits of the new regime, in terms of the additional investment which GAL is planning to commit through to 2020/21 and the acceleration of projects to meet demand.

We will provide evidence to the CAA on the questions highlighted:

- how the investment programme has changed compared with the programme the CAA considered during the last periodic review (Q6) and the main reasons for this;
- whether there is any evidence that GAL's investment decisions have affected on-time performance (or are likely to do so in future); and
- how passengers' interests are taken into account.

⁶ Airline punctuality at Gatwick, October 2015; Summer readiness, April 2016 [to be submitted]

⁷ Draft 2016 Capital Investment Programme, April 2016 [to be submitted], Engaging with passengers to improve their experience of Gatwick, February 2016

We will also provide evidence on:

- GAL's efficiency in the delivery of capital projects;
- how GAL ensures that benefits from projects are tracked and delivered through the investment cycle; and
- review of key projects delivered in 2014/15 and 2015/16, highlighting reasons for any significant variance between plan and outturn.

3.4. GAL's relationship with airlines and other stakeholders

We support the CAA's focus on our relationships with airlines and other stakeholders as part of the review of the regulatory framework. As noted above, we have already provided initial briefing to the CAA on how we engage with passengers to understand their views. We have also provided a description of the evolution of airline contracts and the beneficial impact that the new framework is having on the quality and productiveness of our multilateral and bilateral contacts with our airline customers⁸.

In reviewing GAL's relationships with airlines since April 2014, the CAA should be mindful that both we and airlines are to some extent learning as we go how best to operate in a new regulatory environment, following several decades of traditional and progressively more restrictive RAB-based price controls. We have sought to understand airlines' views about the process and content of consultation during the first two years of the new regime, and to respond accordingly where we saw opportunities to improve. One example of such a response is our establishing the monthly Operations Consultation Forum, which provides a comprehensive high level overview of all operational initiatives affecting airlines and their ground handlers. The Forum has enabled GAL to communicate its plans effectively and to take timely guidance from airlines about their priorities.

3.5. Other issues within the proposed scope of the review

3.5.1. Bilateral contracts

We agree with the CAA's proposal to carry out a brief overview of GAL's contracts with airlines to assess whether they have enabled service, operations and investment to be better tailored to the needs of individual airlines and their passengers. We believe that the contracts now in place have delivered the anticipated benefits to a broad range of airlines which together account for over 80% of Gatwick's passengers, while all airlines continue to benefit from fair pricing and good service delivery via GAL's Commitment.

In conducting its overview of contracts, the CAA should be mindful that each is, by its very nature, the outcome of a bilateral negotiation between two commercial parties. Each airline enters into such negotiations with its own judgement about its future business prospects at Gatwick and the risk-reward balance associated with particular contract terms. GAL also has a range of objectives, such as getting best commercial use from relatively under-utilised capacity in winter and off peak periods, and broadening the range of long haul destinations served, which will influence its negotiating stance towards different airlines. As such, the diverse range of contract terms which have been agreed reflect the diverse objectives of each side. These are commercial contracts between consenting parties and the CAA should therefore not judge the benefits to passengers of the contracts by the extent to which each airline achieves contract terms close to the most

⁸ Evolution of airline contracts, April 2016 [to be submitted]

favourable ones agreed by GAL, as clearly the priorities and opportunities for each airline are very different.

3.5.2. Level of airport charges

We agree that the CAA review should include a validation of GAL's calculation of the comparison between its blended price and our fair price benchmark.

With regard to a forward view of airport charges in future years, GAL has, as noted above, provided in this year's announcement on airport charges for 2016/17 an indication of the likely rate of growth of the Planned Gross Yield per passenger for 2017/18. Beyond that date, GAL's Commitments clearly provide a binding upper limit on the growth in airport charges through to 2020/21.

3.6. Issues not in the proposed scope of the review

We agree with the CAA's proposals to keep the review of the regulatory framework focused and time limited, and not to resemble a reopening of the 2014 settlement. To that end, we agree with the CAA that the following issues should not be in the scope of the review:

- monitoring framework;
- operating expenditure and commercial revenues; and
- wider airport developments at Gatwick, such as the process for making decisions about the number and timing of take-off and landing slots each season, or the drawing up of future plans for the development of the airport.