

Encouraging investment- CAA contribution to Ofgem workshop on 'The Future of Energy Regulation in Britain'

CAA presentation to
Ofgem energy regulation workshop
11 December 2008

User involvement in regulating investment – CAA experience in airport regulation

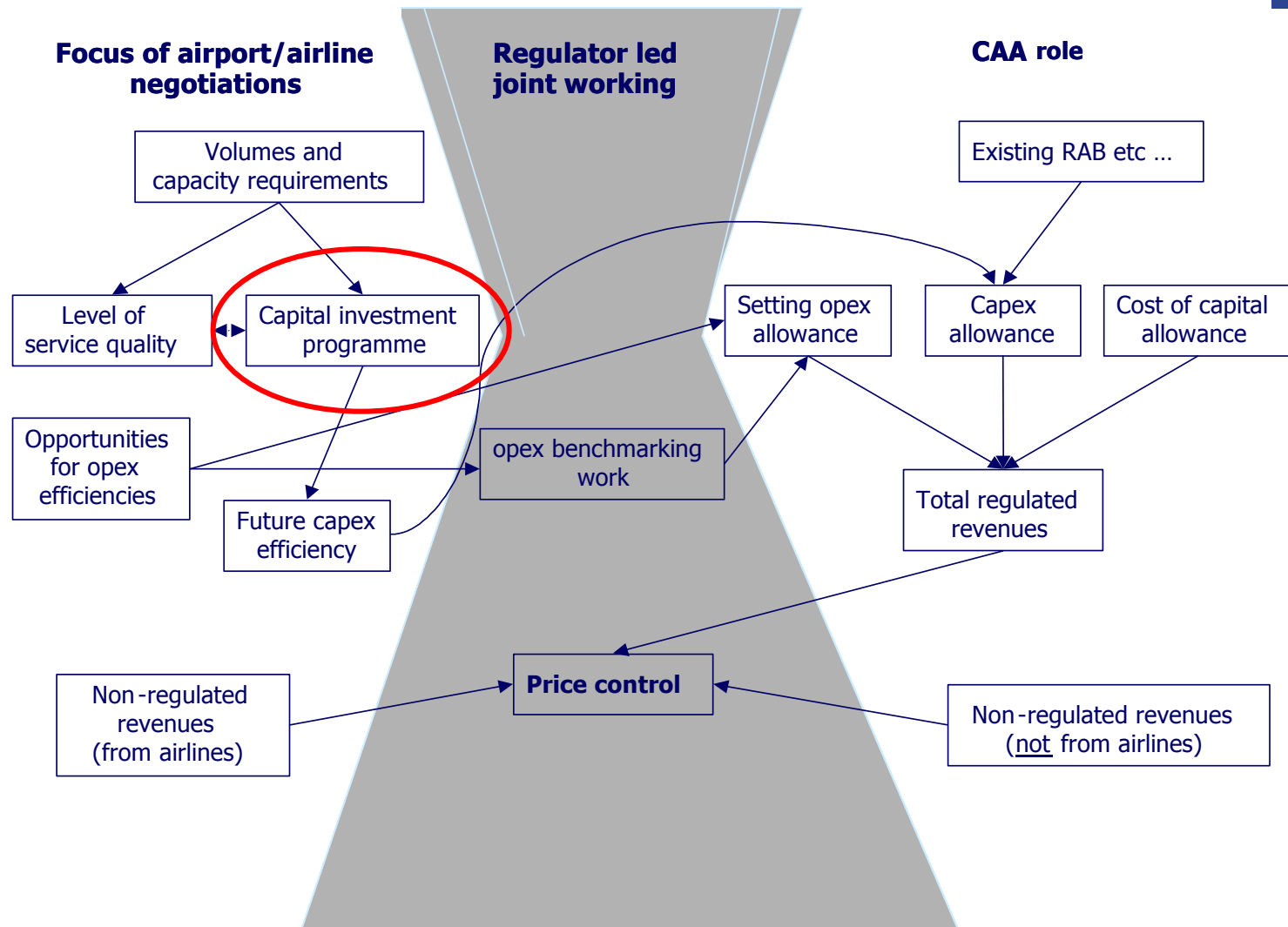


- What did the CAA attempt, and why?
- What happened, and why?
- What lessons can we learn, for regulation of airports, and possibly for energy regulation?

Constructive engagement - rationale

- Opportunity
 - move the process of economic regulation closer to users' requirements, conducted in users' language, following lessons learned from 2001-03 price review (dual till, tariff basket, price path commitment)
 - airports and airlines interact with the final customer, close daily interaction between airlines and airports, relative importance of service ...
 - ... suggesting airlines and airports – relative to regulators – were well-placed to review service and investment
- CAA proposal
 - to the greatest extent possible base the price control review on direct engagement / negotiation between airlines and airports so that...
 - ... as long as the negotiation processes meet the CAA's objectives in respect of the interests of future users, and passengers ...
 - ... agreements would be adopted by the CAA in setting the next price control
 - CE was only ever intended only to inform, not determine, investment

Constructive engagement – proposed structure



Constructive engagement – results (Heathrow and Gatwick)



- Process determined by airports and airlines, within bounds set by CAA
- Joint steering team of airport and airlines, jointly chaired
- Working groups on specific topics:
 - Service quality, Capex, Traffic forecasts, Non-regulated charges
- Joint submissions to CAA, identifying agreements and disagreements
- Good consensus on strategic vision for airport development
- Valuable detailed work on scope and detail of service quality regime
- Fairly close alignment on traffic and on overall capex priorities
- Significant challenges to CE, especially in last months of price review
 - Information flow from BAA, particularly towards the end
 - Changing cost estimates for service delivery (especially security process)
 - Changing scope and cost of capex programme
 - Negotiation against background of major price rises proposed at Heathrow
- Much closer CAA involvement in 'end game'
 - Technical scrutiny of capex plans
 - Intense scrutiny of opex and service quality projections

[NB aspects of Gatwick price control review currently subject to judicial review hearing in 2009]

Constructive engagement – results (Stansted)

- CE did not get started effectively at Stansted in 2005 (overshadowed by disagreement over timing and cost of second runway)
- Airlines pressing for full 'open book' negotiation with BAA on all aspects of business plan, up to and including regulated charges - BAA unwilling to disclose full commercial details to airlines
- CAA concluded that
 - airlines' demands went beyond terms for CE
 - stand-off between airport & airlines meant CE unlikely to deliver in time
 - CAA concluded in Dec 2005 that CE at STN unlikely to deliver results and took back responsibility for regulator-led work during 2006
- CAA conducted benchmarking studies during 2006, plus market analysis
- CAA concluded (Dec 2006) that STN faced competition, calling for lighter regulation
- Government decision Jan 2008 to maintain price controls
- Regulator-led analysis by CAA and Competition Commission during 2008
- CC itself convenes capex consultation, and secures consensus on a core programme
- CAA price cap proposals Dec 2008:
 - Follows CC lead on overall airport charge revenue cap, but also set with close eye on impact on developing competition between airports
 - Conditions proposed on airport's consultation with airlines; facilitator to be appointed

Constructive engagement – accounting for results

- Heathrow:
 - good alignment between BAA and major airlines & alliances about strategic vision (multi-alliance hub, with 'competitive equivalence' for all up to T5 standards, improve resilience, secure mandate for extra runway)
 - changing opportunities to, and constraints on, investment – plans evolving significantly through to end of price review – CAA capex scrutiny on risk to delivery
 - overlapping regulatory and capital planning cycles – new information affecting regulatory decisions, but also undermined user confidence in BAA
 - cost impact – overall price only emerged fully late on, putting pressure on airlines
- Gatwick:
 - broad alignment on strategic vision (maximise use of existing runway and terminals, but with more flexible airfield and better quality pax experience)
 - key issue was timing of next wave of major enhancements (new piers, baggage system) – early consensus on lower capex variant eventually resulted in weaker airline support for higher capex plan, endorsed by CAA
- Stansted:
 - no alignment on medium-term strategic vision: BAA pushing for early runway (in line with Government White Paper), airlines seeking to defer major capex and reduce costs radically
 - short-term alignment on making best use of existing facilities in next 5 years, with limited asset replacement and projects timed to traffic growth
 - CAA seeking to reduce the regulatory incentives on BAA and airlines to promote / block (respectively) major capacity increments, by reducing the influence of the RAB in price caps

What can we learn from constructive engagement?

- Extra capacity or better quality assets (runways versus terminals)
 - CE worked better for the latter than the former
 - Airlines' and passengers' interests aligned better on improving existing capacity
 - Potential divergence at Stansted between incumbent airlines and BAA, with passengers' interests somewhere in the middle
- Users: who are they and what do they want?
 - Airlines and passengers: the former are constructively engaged, the latter rely on airline competition and CAA 'over-ride' of CE outcomes
 - Differing airline views: CAA hoped for consensus but allowed for dissenting views
 - Airlines versus passengers: investment in connectivity across airport great for passenger experience & competition, may be less great for airlines seeking to keep passengers from transferring to other carriers
 - Time horizons of airline views: a terminal is for life, not just for Christmas ...
- Users: what do they know?
 - Airlines bring global insight in terminal design and airfield infrastructure, good at influencing strategic priorities
 - Airlines less well equipped to challenge costs, sequencing, risk management
 - Passenger views, through industry-wide surveys, shape thinking on airport design

Applying constructive engagement

- Constructive engagement struggles where supplier and users fundamentally at odds – deal with this up front through regulatory framework
- Users' incentives – understand their market positions, objectives, and financial commitment to results from constructive engagement
- Define scope, objectives, timetable for engagement clearly up front, along with protocol for conduct of consultation
- Develop dialogue between regulator and supplier-user consultations – clarify emerging questions, feedback on early results, add in independent evidence to inform engagement
- Be flexible – step in where need be, steer discussions which are becoming unproductive, take back issues where inadequate progress made, have orderly process for dealing with new information
- Build confidence in users that it is worth their while investing time in constructive engagement
- Integrate constructive engagement with supplier's normal cycle of investment planning and implementation