

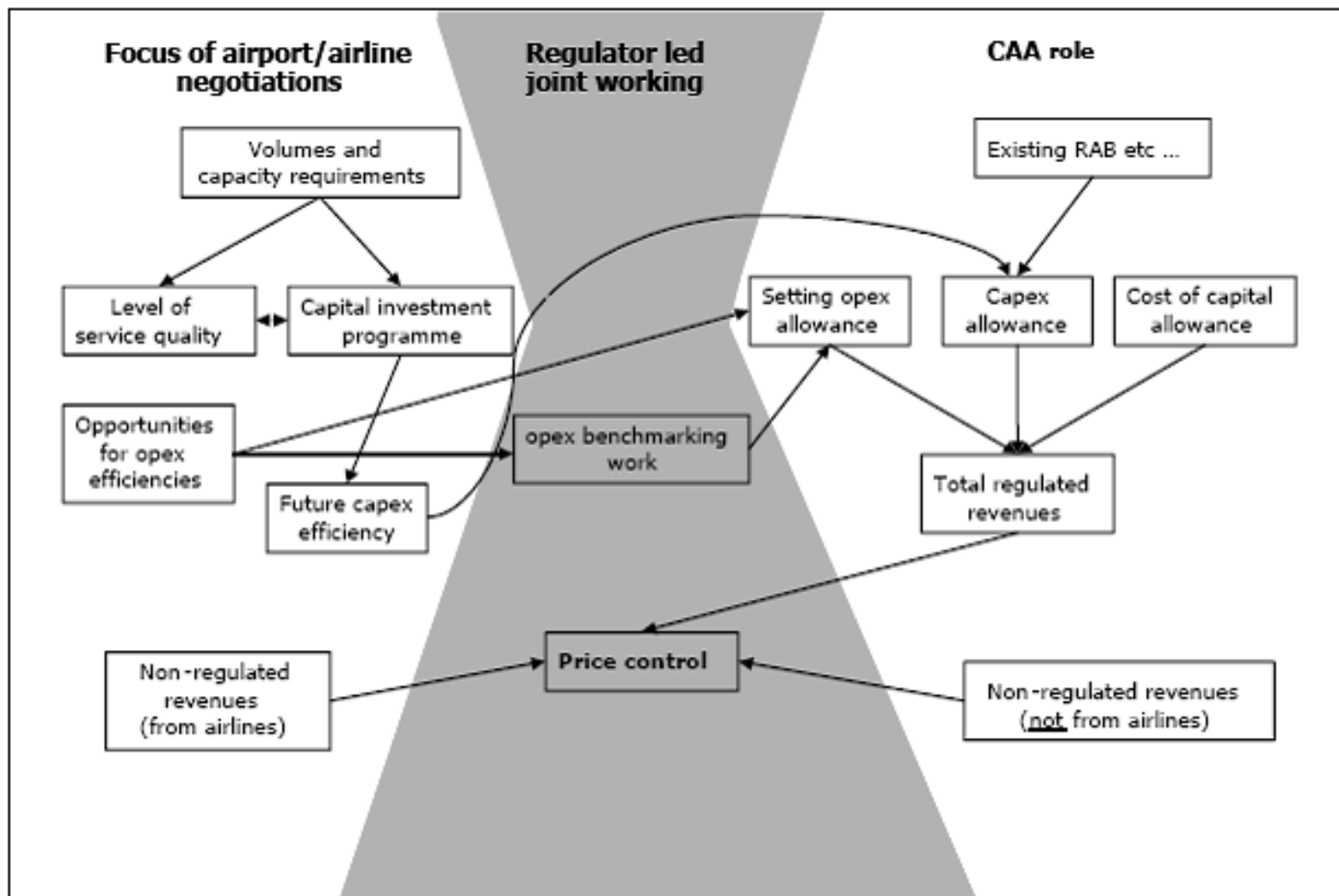


# Pros, Cons & Practicalities of Constructive Engagement in Airports: an Airline Perspective

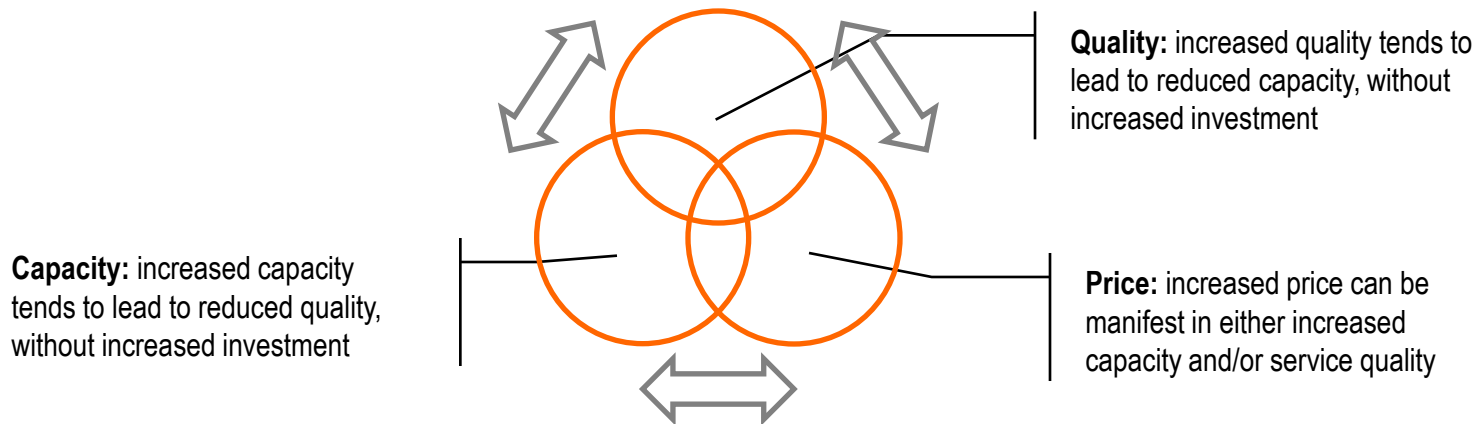
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Regulating energy networks for the future: RPI-X@20  
2<sup>nd</sup> July 2009, Imperial College London

- During the Q4 review, BAA was heavily criticised for poor information disclosure and poor consultation with users.
- Prior to its statutory reference to the CC, the CAA required an undertaking from BAA to provide enhanced information disclosure to airlines (Annex 4), stating that consultation should take place *‘around a central business plan.’*
- In 2004, Sir Roy McNulty (CAA Chairman) said: *‘... it would be odd, and apparently contrary to their interests, if airlines failed to engage with BAA in discussing the merits of alternative development options.’*
- At the start of the Q5 review, the CAA published its proposals for airports and airlines to work to identify areas of agreement, allowing the CAA to focus on areas of disagreement: *‘Airport Regulation: the Process for Constructive Engagement.’*



- Consultation requires that discussions take place:
  - on a basis of shared information;
  - prior to decisions being taken and at such a time as could influence decisions; and
  - with a genuine possibility of proposals being modified on the basis of the outcome.
- The choice is essentially a trade-off between capacity, quality and price, the outcome of which depends on how the participants perceive value:



- Constructive Engagement during the Q5 review fell spectacularly short of these criteria; however, the CAA did not step in.

- Airlines are relatively sophisticated users with significant commercial interests in the outcomes of consultation; however, at Gatwick they were swamped with material (not information), corralled into 36 committees, out-resourced and out-manoeuvred.
- At Stansted, Constructive Engagement had *'failed'* by the end of 2005; however airlines continued to engage BAA, the CAA and the CC through a single body (the ACC).
- The Q5 settlement at Gatwick is in no way the product of airline/airport *'negotiation'*; rather the CAA allowed BAA's forecasts of passenger traffic, CapEx, OpEx (pre-November 2008 + £111m) and other revenues. The CC roundly condemned BAA's consultation performance and criticised the CAA for inadequate regulatory oversight...
- The situation at Stansted is different...

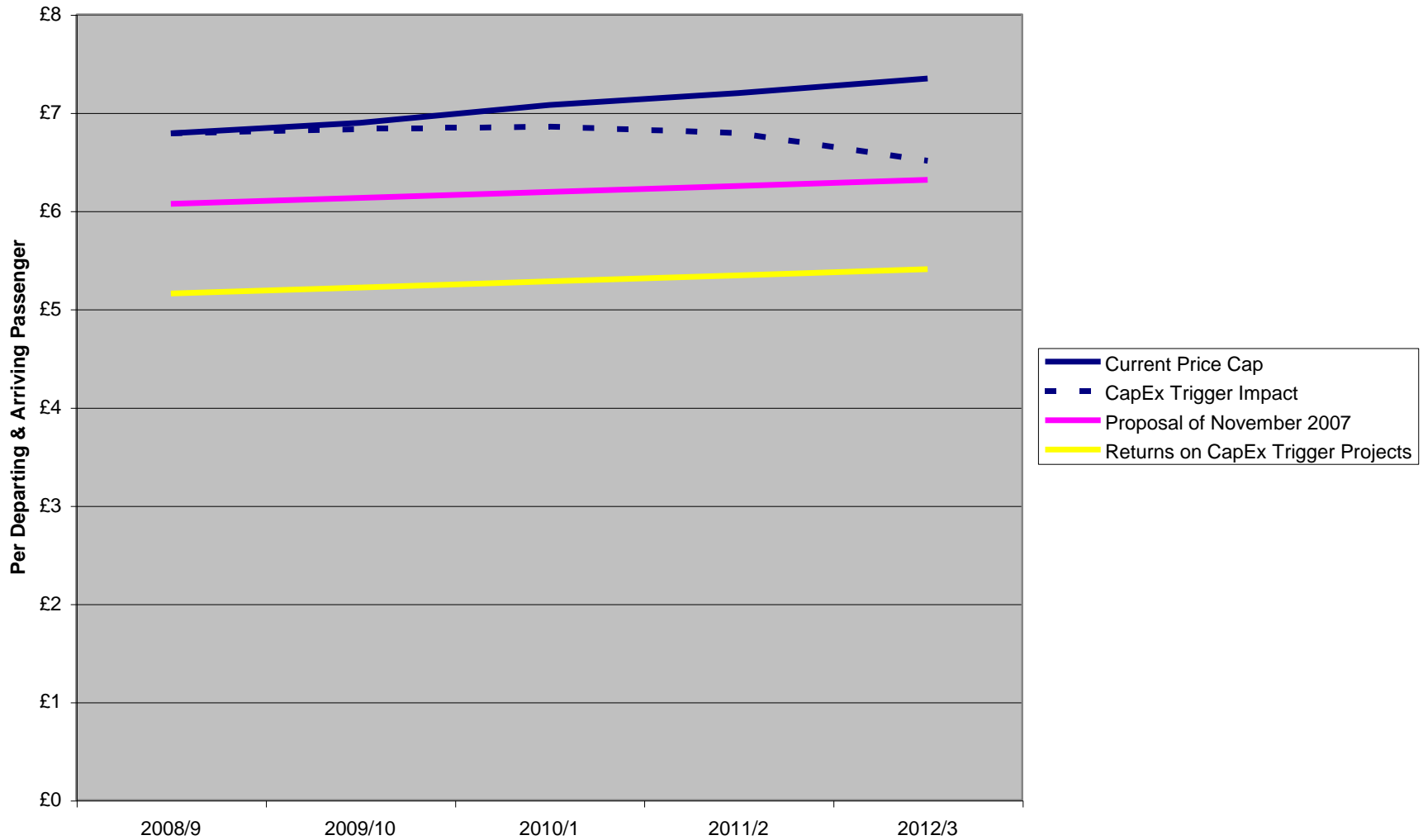
- *'... weaknesses in consultation processes [and] '[w]eaknesses in Constructive Engagement [...] included: asymmetry in information [...]; the scope for BAA to [...] play one airline off against another; control by BAA over the timing of the release of information to the airlines [and to] the CAA.'*
- *'... the shortcomings of [the regulatory system] are exacerbated by the operation of the regulatory system; in particular, the CAA's not facilitating an adequate process of consultation to enable an informed dialogue to take place... including: not facilitating the provision by BAA to the airlines and others of adequate information on a timely basis; its reliance on Constructive Engagement but failure to act when it fails [...]; its failure to enforce the provisions of the previous agreement on consultation with BAA in Annex 4 [...] including its acceptance of a [CIP] rather than a business plan; [and] the CAA's reliance on triggers...'*
- *'... there are a number of findings which, taken as a whole, lead us to conclude that regulation is a feature which restricts competition. These include: [...] lack of clarity for BAA as to the real meaning in the eyes of the CAA of what constituted adequate consultation [...]*

- In March 2007 the CAA made a statutory reference to the CC, adopting BAA's CapEx and OpEx forecasts, but in July 2007, BAA made a late submission to the CC, increasing CapEx from £463m to £892m, based on development of Pier 7 to which airlines are opposed; however, the CC did not have time to analyse these increases.
- The CC said: '*... BAA told us that a lower capital expenditure had originally been agreed with the airlines; but a higher amount was then suggested by BAA on the initiative of Ferrovial. The further increase following our report was accounted for by the Pier 7 project...*'
- Despite the CC's misgivings and airlines' increasing opposition, the CAA adopted this increased CapEx into its November 2007 firm proposals, but not an additional £267 OpEx proposed by BAA shortly before the CAA published.
- This was subject to severe criticism from airlines; however the CAA allowed £111m additional OpEx into the Q5 settlement, which became the focus of easyJet's Judicial Review.

	2008/9	2009/10	2010/1	2011/2	2012/3	Total	Variance	
<b>CAA (March 2007)</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£5.33	£5.37	£5.41	£5.46	£5.51	<b>£5.42</b>		
<i>Aeronatical Revenue (nominal)</i>	£185m	£188m	£192m	£197m	£201m	<b>£963m</b>		
<b>CC (September 2007)</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£6.08	£6.03	£6.01	£5.98	£5.95	<b>£6.01</b>	<b>£0.59</b>	10.89%
<i>Aeronatical Revenue (nominal)</i>	£220m	£221m	£221m	£223m	£224m	<b>£1,109m</b>	<b>£146m</b>	15.19%
<b>CC (September 2007) w/business rates adjustment</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£5.91	£5.86	£5.84	£5.81	£5.78	<b>£5.84</b>	<b>-£0.17</b>	-2.85%
<i>Aeronatical Revenue (nominal)</i>	£214m	£215m	£215m	£217m	£218m	<b>£1,078m</b>	<b>-£32m</b>	-2.85%
<b>CC (September 2007) w/lower other revenues assumption</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£6.06	£6.01	£5.99	£5.96	£5.93	<b>£5.99</b>	<b>£0.15</b>	2.59%
<i>Aeronatical Revenue (nominal)</i>	£219m	£220m	£220m	£222m	£224m	<b>£1,106m</b>	<b>£28m</b>	2.59%
<b>CC (September 2007) w/higher pensions provision</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£6.14	£6.09	£6.07	£6.04	£6.01	<b>£6.07</b>	<b>£0.08</b>	1.33%
<i>Aeronatical Revenue (nominal)</i>	£222m	£223m	£223m	£225m	£227m	<b>£1,120m</b>	<b>£15m</b>	1.33%
<b>CAA (November 2007)</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£6.23	£6.51	£6.83	£7.15	£7.48	<b>£6.88</b>	<b>£0.87</b>	14.51%
<i>Aeronatical Revenue (nominal)</i>	£226m	£238m	£251m	£267m	£282m	<b>£1,264m</b>	<b>£154m</b>	13.93%
<b>CAA (March 2008)</b>								
<i>Profiled Yield/Passenger (nominal)</i>	£6.97	£7.29	£7.63	£7.99	£8.35	<b>£7.69</b>	<b>£0.81</b>	11.73%
<i>Aeronatical Revenue (nominal)</i>	£250m	£265m	£281m	£297m	£315m	<b>£1,408m</b>	<b>£144m</b>	11.41%

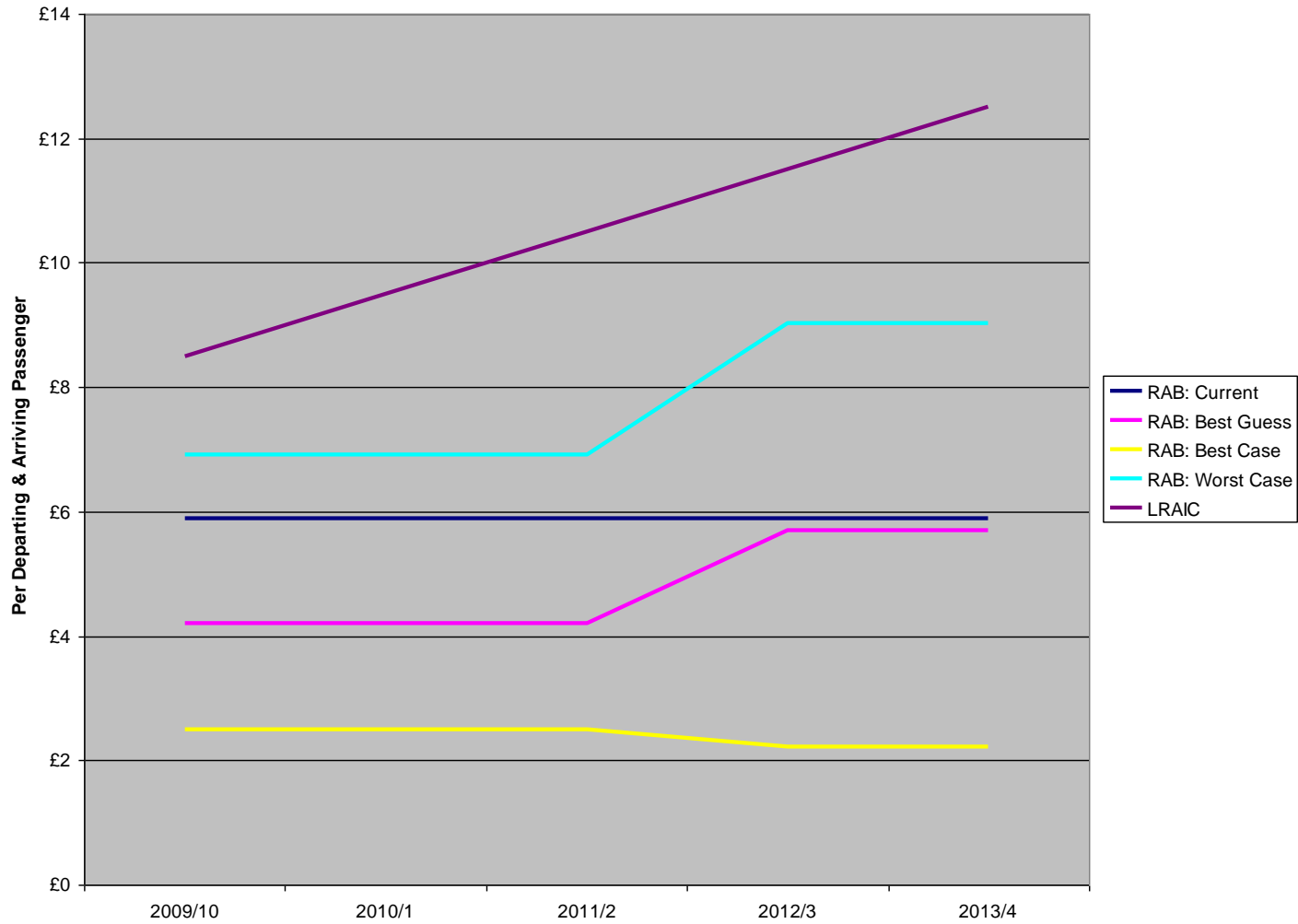


# Gatwick: Potential Price Cap Profiles for Q5



- In December 2005 BAA published plans for SG2, costing £2.7bn (subsequently successively reduced to £1.6bn - £1.8bn), while airlines disputed the costs and contested the inclusion of SG2 CapEx into the Q5 RAB.
- Meanwhile in 2006 the CAA petitioned to have Stansted de-designated (extending Q4 by one year) and formally advised the DfT accordingly in June 2007; however, in January 2008 the DfT decided that regulation at Stansted would continue.
- In January 2008 the CAA made a statutory reference to the CC, without having analysed the regulatory building blocks, recommending instead *'market-led'* or *'precautionary'* price caps.
- The CC did not agree with the CAA's recommendations and instigated an intense airline/airport consultation, which it facilitated and which resulted in broad agreement.

# Stansted Potential Price Cap Profiles for Q5



- Returns to the philosophy of 2004, unambiguously setting out requirements for information disclosure:
  - ‘requires a ‘strategic business plan’’;
  - ‘requires a ‘master document log’’;
  - ‘[requires] significantly more detailed [information]’;
  - ‘requires a breakdown of specific costs of each project and the pricing implications’;
  - ‘requires specification of how much commercial revenue realised from individual projects would be incremental’;
  - ‘requires cost benefit analyses... for both [the airport] and [airlines]’;
  - ‘is more specific on the stages in each project when those projects should be consulted upon’;
  - ‘requires the provision of information of cost benefit implications of any change in individual projects’;
  - ‘requires the appointment of a facilitator’;
  - ‘has a provision on timeliness, transparency and auditability of information’;
  - ‘requires a maintenance plan’.
  
- Developed at Stansted and transcribed onto Heathrow, but not Gatwick, as an imminent sale was anticipated.

- As airlines see continued under-investment in Gatwick's infrastructure (for which they are paying) and OpEx savings (in which they cannot share), relationships with the airport and the CAA are likely to continue to deteriorate.
- There may be a small window of opportunity following a sale of Gatwick; however, any new owner will find themselves in the same market position as was BAA.
- Improved relationships at Stansted appear to be based on the shared regulatory contract concerning the manner in which consultation on short term development will be conducted – and the setting aside of long term development.
- The importance of facilitation cannot be over-emphasised.