

# Constructive Engagement in the Aviation Sector

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# Timeline of Constructive Engagement (CE) in the UK

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**1986** – Airports Act is the basis for economic regulation of UK airports by the CAA

**2004** – Move from declining prices to rising prices (e.g. Heathrow) and increasing airline focus on costs leads to the origins of CE. CAA also issue a consultation paper on looking to the future.

**2005**– CAA set out its expectation of the shape the CE process would take in four main areas: regulatory approach, division of responsibilities, guidance on the process and regulator-led joint working, and protection of users’ interests.

In December, the CAA assessed that there were good prospects of CE delivering value for Heathrow and Gatwick, but this was not the case for Stansted.

**2007** – CC market investigation into BAA airports

**2008** – easyJet legal challenge against Gatwick March 2008 price control decisions

# Timeline of Constructive Engagement (CE) in the UK – Q6

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**July 2011** – CAA consult on principles for the Constructive Engagement (CE) process

**Mar 2012** – A different mandate for CE is developed, differing for each regulated airport

**Apr 2012** – The formal CE process begins, including forming a CE Working Group (CEWG)

**Sep 2012** – CEWG sends update of CE process

**Nov 2012** – CEWG delivers a final report setting out areas of agreement and disagreement for each main element of the price control

**Apr 2013** – CAA publishes initial economic regulation proposals for consultation

**Sep 2013** – CAA issues final proposals

**Jan 2014** – CAA Q6 decision

**Apr 2014** – Q6 Economic regulation comes into effect

## What is covered under CE?

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The process of CE for Q6 is broader than for Q5 and all the elements of the price control are within scope. This will form a statement of agreement and disagreement between the airport and its airlines.

The objectives of the process for CAA are:

- to set price controls that are as well informed as possible about users' future requirements for service, capacity, resilience and cost efficiency.
- to enable airline customers to engage with the airport of plans for Q6.
- to enable airports to engage with customers to develop its Q6 business plan.
- to provide a forum for participants to state views and provide CAA with a clear view of this.

The constructive engagement process will work alongside regulator-led studies and feed back into the CAA's role in setting the price control.

## Review of CE 2005-2010

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For Heathrow and Gatwick in 2006-8, the CE process became protracted due to a degree that the CAA did not envisage at the outset.

Meanwhile at Stansted in 2005, the process made little progress and in December they concluded that the lack of substantive progress led to a reversion to a more traditional regulator-led approach.

While there was some dialogue between 2006 and 2007, there were 'no useable outputs to inform the CAA's eventual price control options and its reference to the Competition Commission in April 2008.'

There would be some dialogue and a consultation around capital expenditure and service quality standards, but the process did not proceed as imagined at the start of the process.

A cause for this difficulty, according to the Stansted 2010 price control document, was around whether BAA should provide a business plan and this occurred too late for the airlines to enter into meaningful debate.

## But not all bad....

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One of the major investments considered at the Q5 determination was PSDH

Is essentially T6 and R3

Although both projects were some way off, it was expected £600m of investment was needed during Q5. Not insignificant as this was still start-up phase

But great uncertainty about the need for the investment as it all depended on when a planning permission hearing started and when approval (if any) was granted

CAA proposed just introducing the amount into the control as an ex ante allowance

The airlines wanted this to be based on a set of triggers

BAA agreed and negotiated a set of informal triggers which, if not met, meant that it would voluntarily keep charges down

Exactly what you would expect in a privately negotiated contract....

Is an example of constructive engagement which worked in spite of, rather than because of, the regulator

## Overall lessons

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The Q5 price control review of BAA's airports were usually contentious and a range of factors external to economic regulation (the prospect of new runways at Stansted and Heathrow, competitive dynamics, the BAA plc takeover, the CC's market inquiry and increased security concerns) meant the CE during Q5 was difficult. Some lessons to be taken from this were:

- Information flows must be delivered as early as possible and as complete as possible.
- A range of options rather than a preferred option should be chosen.
- The regulator is required to take a greater role in the process and oversee the process. The CAA was criticised by the CC for its lack of engagement in the process and should have provided more scrutiny of the process, stepping in where required.
- CE was fairly broad, but the absence of major issues (e.g. opex, commercial revenues and cost of capital) meant that airlines did not have a full picture of airport charges and left them in a difficult position with respect to negotiating. Choosing a broader scope would be useful here.
- By entering into dialogue with incumbent airlines, the capital plans may be restrictive in terms of airline competition in future years.