

News Release



30 March 2007

CAA REFERS PRICE CONTROLS FOR BAA'S HEATHROW AND GATWICK AIRPORTS TO THE COMPETITION COMMISSION

The UK Civil Aviation Authority (CAA) today published its reference to the Competition Commission, as required by statute, and accompanying regulatory analysis and proposals for two of BAA's airports designated for price control, Heathrow and Gatwick. Two key themes in the CAA's proposals are improving the quality of service to passengers and encouraging timely investment to improve each airport's infrastructure. This is a key stage in the CAA's periodic review of price controls for these airports, which started in December 2005 and culminates in new price controls set in March 2008 for the five-year period from 1 April 2008.

In today's publication, the CAA puts forward recommendations, building on its initial proposals of December 2006, and reflecting recent consultation and analysis, which are very similar to these earlier proposals. The indicative ranges for the maximum rate of increase in airport charges remain as set out in the CAA's initial proposals: RPI+4 to RPI+8 per cent at Heathrow (compared to the current rate of growth in price caps of RPI+6.5 per cent), RPI-2 to RPI+2 per cent at Gatwick (compared to the current rate of growth of RPI+0 per cent). The CAA has also maintained its recommendations for the cost of capital, a range for Heathrow of 5.9 to 6.2 per cent, and 6.3 to 6.7 per cent for Gatwick, pending examination by the Competition Commission.

The main changes since December reflect:

- a greater emphasis on service quality to passengers with:
 - CAA support for better service standards to deliver a reduction in queuing time in security;
 - greater financial penalties on BAA where passenger service falls short;
 - incremental bonuses for BAA if passenger service across each airport is significantly above agreed standards, to encourage continuous improvement in performance;
- renewed emphasis on the importance of timely investment through:

PN1807

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Civil Aviation Authority

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- extending into Q5 the use of financial trigger payments to reward the completion of key capital projects;
 - recognition that the cumulative effect of missing such triggers should provide a significant disincentive to any unwarranted delay in capital expenditure;
 - CAA preparedness to take back allowed returns where BAA fails to deliver investment previously forecast for financial rather than operational or related business reasons; and
- an overall downward revision to projected operating costs of 3 per cent (Heathrow) and 0.2 per cent (Gatwick), reflecting enhanced costs for security offset by reductions in other areas following further analysis (for example, on utility costs).

Commenting on this, Dr Harry Bush, CAA Group Director, Economic Regulation, said:

“The CAA’s recommendations to the Competition Commission in support of its price control reference build on and largely confirm the CAA’s initial proposals. The CAA considers that it has struck an appropriate balance in challenging BAA to continue to improve its operating efficiency and service quality, and providing adequate rewards for timely investment at Heathrow and Gatwick. It now awaits the Competition Commission’s analysis and advice on these important issues.

“The CAA wants to see a better passenger experience at Heathrow and Gatwick. That is partly about new facilities, such Terminal 5 at Heathrow. But it is also about better service, efficiently and well delivered. The CAA’s proposals to increase the penalties for poor performance and to introduce rewards for improving performance are intended to sharpen further BAA’s focus on the passenger.”

The full document is available on the CAA website at

www.caa.co.uk/docs/5/ergdocs/ccreference_march07.pdf

For media enquiries contact Chris Mason on 020 7453 6026.

Notes to Editors

CAA’s economic regulation of UK airports

The CAA is responsible for the economic regulation of airports under the terms of the Airports Act 1986.

In exercising its functions, the Act requires the CAA to set maximum limits in a manner best calculated to:

- (a) further the reasonable interests of users of airports within the United Kingdom;

- (b) promote the efficient, economic and profitable operation of such airports;
- (c) encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
- (d) impose the minimum restrictions that are consistent with the performance by the CAA of its regulatory functions,

and in doing so, to take into account such of the international obligations of the UK as may be notified to it by the Secretary of State.

Setting price controls

The Airports Act 1986 requires the CAA to set maximum limits on airport charges at airports designated for this purpose by the Secretary of State for Transport. These airports are: BAA's London airports (Heathrow, Gatwick and Stansted) and Manchester airport. Before setting new controls, the CAA is required by the Airports Act to refer the price controls for each airport to the Competition Commission, which then conducts its own review lasting around six months before reporting back to the CAA. The CAA must have regard to the Competition Commission's report, but the CAA is the final decision-making body with respect to price controls.

In March 2007, the CAA extended the current price controls on Stansted Airport by 12 months, so that they will expire on 31 March 2009. This extension was implemented in order to allow time during 2007 for the Department for Transport to conduct its own policy review of the criteria for the Government to decide whether an airport be designated for price control by the CAA, and then to consider the cases for de-designating Stansted and Manchester airports. If Stansted Airport were to remain designated for price control, the CAA would bring forward a reference to the Competition Commission in spring 2008.

Current price controls at Heathrow and Gatwick

The CAA published, in February 2003, the results of the last review of BAA's London airports, covering the five-year period between 1 April 2003 and 31 March 2008. In 2006/07, the price caps are £8.51 per passenger at Heathrow and £4.73 at Gatwick. (In 2007/08, the price caps are projected to be £9.05 at Heathrow and £4.79 at Gatwick in 2006/07 prices.) For Heathrow, the maximum increase per annum is set at RPI plus 6.5 per cent; and for Gatwick RPI plus 0 per cent.

Future price controls at Heathrow and Gatwick

The timetable for this review of Heathrow and Gatwick airport is:

30 March 2007	CAA makes price control reference to Competition Commission for Heathrow and Gatwick airports
September 2007	Competition Commission reports to CAA on price control reference
November 2007	CAA publishes firm proposals for the 5 th Quinquennium (Q5)
January 2008	Consultation closes, oral hearings
March 2008	CAA announces price cap decision for Q5
April 2008	Q5 starts 1 April

The CAA has asked the Competition Commission to report within a period of six months, i.e. by end September 2007. Thereafter, the CAA anticipates that, having regard to the Commission's report, it would publish its own firm price control proposals by November 2007 for a further period of consultation, before making its final decision by March 2008 for Heathrow and Gatwick price controls for the five-year period starting 1 April 2008.

Investment

Rising demand and the need to upgrade existing infrastructure and services is evident in the scale of BAA's investment programme, focused currently at Heathrow on the new Terminal 5 that will open in 2008. Significant further investments are planned in airfield and terminal infrastructure, to enable better use of the existing runway capacity and to give an improved passenger experience. Capital expenditure at Heathrow and Gatwick is projected by BAA to be some £3.3 billion (2006/07 prices) in the five years from 2008 compared to £6.0 billion (2006/07 prices) in the current price control period.

Service quality

In the current price controls for Heathrow and Gatwick, each airport operates against a set of service quality standards with rebates paid by the airport to the airlines for any failure to meet these standards. Each airport is exposed to a maximum level of rebates in any one year of 3 per cent of total airport charges, comprised of 1 per cent related to aerodrome congestion, 0.5 per cent related to passenger survey scores for various terminal facilities, and 1.5 per cent for other services including security queuing and airline-facing services. In total some 0.9 per cent relates to passenger-facing activities. The CAA's recommendations to the Competition Commission include proposals: to double the rebate levels for passenger-facing services (from 0.9 to 1.8 per cent of airport charges); to include new service measures proposed by the airlines and airports (to which rebates of around 0.5 per cent would be attached at Heathrow); to introduce bonuses for improving performance across the airport in passenger-facing services (maximum bonuses worth 1.8 per cent of airport charges); and to rebalance the remaining rebates away from aerodrome congestion (rebates down to 0.5 per cent from 1 per cent) and towards the other airline-facing service elements (where maximum rebates would rise from 1.1 to 1.6 per cent). Overall, maximum rebates at Heathrow would rise from 3 per cent to 4.5 per cent of airport charges, with the opportunity for BAA to achieve a bonus of 1.8 per cent. The same approach would apply at Gatwick where BAA and the airlines are continuing discussions on the scope and definition of any new service quality measures which might be introduced.

Draft Statement of Regulatory Policy

In the document published in support of its price control reference, the CAA has also included a draft statement of regulatory policy, which examines the consistency of the CAA's regulatory policy since the last price control review and sets out the CAA's proposed approach for the future. As part of this, given the recent change in ownership and financial structure of BAA, which have resulted in the airport operator taking on greater financial risks, the CAA proposes to prevent such risks being transferred to users through a number of measures. These include re-affirming its policy of setting price caps by reference to regulatory fundamentals and not to accommodate particular financing arrangements (or stress to such financing), and applying financial incentives for the delivery of investment programmes.