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Reforming the framework for the economic regulation of UK airports

London First welcomes the opportunity to respond to the Government's proposals for reform of the economic regulation of UK airports.

London First is a business membership group whose aim is to improve and promote London to maintain and enhance its position as a leading world city. We do this by mobilising the experience, expertise and enthusiasm of the private sector to develop practical solutions to the challenges London faces and to make the case to central and London government for the investment that London needs in its infrastructure. London First delivers its activities with the support of around 250 of the capital's major businesses in key sectors such as finance, professional services, property, communications, creative industries, hospitality and retail. Our members represent around a quarter of London's GDP.

We outlined our thoughts to the Expert Panel chaired by Professor Cave having reached conclusions on the proposals put forward by the report we published in June 2008: *Imagine a world class Heathrow*. Our response to some of the specific questions posed by the current consultation is based on these conclusions. We continue to seek to address what we believe to be the critical issues from the perspective of the passenger, and specifically the business passenger, at Heathrow airport.

Statutory remit

We welcome an approach that seeks to put the passenger experience at the heart of the regulatory regime. We support the proposal that the Civil Aviation Authority (CAA) be given a single primary duty to promote the interests of passengers, and the duty's current draft wording. We also welcome the broad direction set by the supplementary duties proposed.

We believe it is appropriate that the economic regulator of airports has regard to environmental limits, but consider the duty's current wording will need refining if it is to be effective.

In approving plans for a third runway at Heathrow, the Government has set out the CAA's role in both allowing additional flights and bringing the airport back into compliance should further flights compromise legal air quality and noise limits. We believe the proposed environmental duty would be made clear and effective if it enshrined this role. The duty should prescribe the CAA's role in enforcing the air quality and noise limits attached to the provision of airport services. As such, its focus should be on the effect on the local environment and on local communities, on the basis that Government policy and the National Policy Statement on Airports set the national strategy to tackle climate change. Giving effect to the proposed duty in this way would, in addition, engender public confidence in the credibility of agreed environmental limits.

We support the duty to ensure that, so far as it is economical to meet them, all reasonable demands for airport services are met efficiently. We are concerned, however, that the CAA does not apply the same level of scrutiny over operating and capital costs as other economic regulators. We would welcome a requirement to review capital expenditure, operating expenditure and service provision on an annual basis - through a mixture of benchmarking, yardstick competition and bottom up assessment of costs. The airlines in particular can provide very useful insight into the merits, or otherwise, of proposed investment, notwithstanding our view that airlines are not always an effective 'proxy' for passengers' views.

Having made the case for strengthening ex ante regulation, we recognise that growing competitive forces - both from London airports under independent ownership and local European hubs - *may* provide sufficient market incentives to the Heathrow operator to provide a better, more passenger-focused service. We believe the CAA should have concurrent competition law powers for airport services in the UK and welcome the proposed requirement to promote competition. We believe the CAA will need to deploy its ex ante powers flexibly and proportionately to support, not slow, this development.

The enforcement regime and passengers' needs

We broadly welcome the proposed approach to developing a new licensing regime for airports (including the principle that it be used to implement certain aspects of the Airport Charges Directive), notwithstanding the work needed to flesh out much of its detail.

We strongly support the proposal that Tier 1 licenses include the obligation to report on environmental performance (to support the CAA's enforcing role in this regard); the obligation to comply with service quality standards; and limits to capacity utilisation to ensure that delays are kept to an efficient level.

On service quality standards - given that the outward and inward-bound value chains at Heathrow are fragmented by a variety of process owners and potentially conflicting incentives, we support the principle that the CAA be given powers to intervene to improve coordination, and look forward to the definition of these powers. At the very least, the CAA will need strong information-gathering powers to have all the data - quantitative and qualitative consumer research and transparent, independently-audited operational information - needed to assess the efficiency both of the operator and of the interfaces between different process owners. It should seek, wherever possible, to make this data visible and publicly accessible.

In understanding where the burden of responsibility for operational efficiency lies across the whole value chain, the CAA should assess whether or not the various elements of the value chain are in the right hands with the right contractual framework to create the most passenger-focused ownership structure possible, with punctuality and customer service at its heart. This assessment should provide the starting point for assigning the operator responsibility for the total throughput time of the passenger and extending the Service Quality Rebate (SQR) regime beyond those activities currently directly controlled by the airport operator. The SQR regime metrics will have to reflect the outcomes that define the whole passenger experience, supported by changes in their methods of calculation. Underpinning these reforms should be the CAA's establishment of independent, annual audits of the SQR regime's effectiveness in driving up service levels.

On capacity utilisation limits to tackle delays - the license obligation will require regulatory intervention and a scheduling system based on stronger governance arrangements with a clear set of performance metrics. In simple terms, a standard should be set for delays which, if breached, will require flight numbers to reduce. The regulator should be under a duty to set and enforce these performance metrics.

These metrics will require capacity utilisation to flex as part of a system-wide response to overall performance - in contrast to the current "ratchet effect" in which utilisation ticks upwards. In practice, this will necessitate reform of slot rules at Heathrow. If capacity utilisation is to rise and fall over time to achieve the right balance between runway usage, delays and local environmental performance, then slot rules will have to allow the withdrawal as well as the allocation of slots.

With such high demand for limited runway capacity, airlines have been forced into a situation because of slot ownership in which marginal extra slots deliver a high positive value to an airline acquiring them, but impinge a higher negative cost on all airlines and passengers as a result of variable and excessive delays and waiting times.

We believe a market-based approach to the primary allocation of slots offers the best chance of releasing the "ratchet effect" and achieving the most economically

efficient use of scarce capacity. Capacity is declared, slots auctioned and, when circumstances necessitate a reduction in capacity, a reverse auction takes place. We would welcome the Department's views on this proposal and on the institutional arrangements that should underpin the CAA's role in delivering it.

Consumer representation

We agree with the proposal that Passenger Focus be given responsibility for consumer policy advocacy with regards to airlines and airports, funded by license fees. Passenger Focus should, we believe, deliver a visible and robust policy advocacy function (alongside a responsibility for complaints handling). Consumer panels at leading airports will only support such a function if their views are regularly sought, on both current passenger experience and proposed operational changes that may affect it.

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