



NOTE OF A MEETING
BETWEEN CAA AND GATWICK AIRPORT BOARD
29 JANUARY 2014

PRESENT:

CAA:

Iain Osborne
William Webster

Gatwick:

Sir Roy McNulty
Stewart Wingate
Raphael Arndt – by phone
Nick Dunn
Andrew Gillespie-Smith
James Van Hoften
Andrew Jurenko
David McMillan
William Woodburn
Christine Yokan
John McCarthy – by phone
Wendy Norris - by phone
Kyran Hanks
Robert Herga
Scott Stanley
Guy Stephenson
Andrew Williams-Fry

1. The purpose of the meeting was to discuss the market power determinations (MPDs) published by the CAA on 10 January 2014 and the licensing regime for Gatwick Airport (GAL) beyond Q5.
2. GAL welcomed the CAA's recognition of the Commitments they had made in its final decision. GAL explained they had not yet taken a decision on whether to appeal the MPD or not, but they had a number of observations and questions at this stage. They also wanted some clarification on how CAA would implement the "fair price" regime to be incorporated into the proposed licensing regime and more generally how they intended to operate annual monitoring and the 2016 review.

3. On the MPD, GAL noted that the CAA's approach to market definition was not the same as in previous assessments including the decisions of the Competition Commission (CC) and Competition Appeals Tribunal (CAT) on BAA. They believed the definition of a market which gave them a 100% market share did not reflect the existence of competition from Heathrow albeit constrained, or emerging competition from Stansted. GAL was concerned that the CAA's determination amounted to a position of "super dominance" that would set a precedent for a variety of future decisions. GAL also noted the market definition used in the MPD implies that competition can never have an impact and that this could undermine discussions in the Davies Commission. Finally, GAL also sought CAA's views on the future framework and the conditions required for GAL to move towards greater deregulation in the future.
4. CAA confirmed that they would respond to these issues in writing if Stewart or Kyran wrote to Iain. CAA stated that the market share analysis was only one indicator of many used in the MPD decision. Currently it saw competition from other airports as being too constrained to justify a wider market definition to be used in the MPD. The opportunities for passengers or airlines to switch from Gatwick were not material enough for inclusion in the analysis. CAA had a choice as to whether to include Heathrow in the market but not providing a constraint to Gatwick, or to exclude Heathrow from the market. CAA explained that whether Heathrow was considered part of the market or not would not have affected the outcome. The substance of the issue was whether Heathrow had capacity to accommodate airlines who wanted to switch from Gatwick and while small levels of switching had been seen, standard competition techniques such as SSNIP and critical loss pointed to the exclusion of Heathrow from the market definition.
5. The CAA believed that the market definition used was therefore the most suitable basis for the MPD analysis and an accurate reflection of the current situation. This, however, did not mean that future decisions on either competition cases or regulation would be compelled to use this market definition as a starting point. Future decisions would usually require a fresh analysis, especially if they were focused on particular aspects of airport services. Likewise the market definition did not imply any particular type of regulatory regime. CAA noted that the regime based on GAL's commitments, and backed up with a licence, provided GAL with flexibility and considerable room for a commercial approach despite the outcome of the MPD and the market definition used. The CAA confirmed that they had not adopted the market definition to allow for more rigorous regulation with the decision to support the Commitments Framework being the demonstration of that more flexible approach.
6. CAA added that it had both a legal requirement and a commitment to promote competition where appropriate, and pointed to previous decisions it had made reflecting this. Likewise, CAA's general approach in favour of promoting competition had the support of the Board and was not likely to change given its statutory duties.
7. Finally CAA pointed out that its MPD decision had not been a marginal one in view of the limited motivation for GAL passengers to switch airports (given surface access limitations and costs), and the limited opportunity for switching by airlines at present. The CAA had

been careful not to state that there was no competition between airports but considered that this was not sufficient to provide a constraint to GAL. Although GAL had a right to appeal, it was noted that this could open up the whole regulatory framework for review as it might provoke other stakeholders to appeal other aspects and would take a substantial amount of time

8. GAL enquired what would be the timing and basis of any future MPD decisions in terms of how the impact of contractual changes, commitments, or competition from other airports would be measured, and on what basis CAA would decide whether to perform a revised MPD. In particular, would materiality relate to individual changes of circumstances or could it relate to the aggregate of pre-existing circumstances plus perhaps several different and more recent changes?
9. CAA responded that changes of circumstances had to be material before a new MPD was undertaken, but the notion of materiality could not be taken as relating only to changes that were so great that in themselves they obviously altered the outcome of the determination. Otherwise there would be no point having a materiality test in the statute. Circumstances would be considered in aggregate, and several relevant changes could be considered together with pre-existing circumstances when determining whether or not a new MPD should be performed. The CAA stressed that the statutory scheme gave GAL the power to request a new assessment, by identifying changes that were significant, and in areas that were likely to be relevant to Tests A to C.
10. GAL then turned to the RPI-X framework wishing to clarify how they would demonstrate compliance with the licence requirements. They noted that the annual monitoring, as described, was acceptable but wished to avoid a de-facto revisiting of the entire building blocks calculation on annual basis. GAL also noted that the required prices were somewhat below current tariff levels. GAL asked whether CAA had a view on whether tariff changes or discounts were the best way to ensure that licence requirements were met.
11. CAA did not express a preference on this issue stating that CAA is not a party to detailed negotiations between GAL and its customers. CAA stated that it is up to GAL to demonstrate they comply with the fair price (i.e. RPI-1.6%) requirements in the licence and the need for non-discrimination. In this context non-discrimination means that differences in price or other conditions have to be objectively justified. As far as the annual review is concerned, CAA would expect GAL simply to report on the actual prices being charged. GAL would also be expected to calculate a value for the regulated asset base on an annual basis.
12. As far as the planned review in 2016 is concerned, CAA would expect this to focus on whether the licence requirements were operating in the interest of passengers. It was not anticipating a mini price review or revisit assumptions on, for example, opex efficiency or WACC. CAA would want to be satisfied that there were no pervasive issues around discrimination, customer service and resilience. However CAA also did not wish to undermine incentives on GAL to achieve efficiencies (e.g. to take away the benefits from GAL growing volumes), and to use the capacity at the airport effectively. GAL will have incentives

to grow volumes, so CAA would not expect prices to fall in response to greater growth than was allowed for in the fair price calculation. However, a major traffic shock could result in the “fair price” being revisited.

13. However CAA noted investment levels should not be significantly below plan and, overall, should reflect the interests of passengers. So although GAL has discretion in its planning process, this is not unlimited. On this subject, GAL noted that there was some possible additional capex associated with recommendations from the Davies Commission on surface access. GAL asked how this would be incorporated into the capex framework for the commitments. CAA agreed to examine this after the meeting.
14. It was agreed that a note of the meeting should be circulated and, ideally, agreed between CAA and GAL and then published. GAL also undertook to write to CAA noting any outstanding issues. GAL noted that it would make a final decision end-February \ beginning-March about whether to appeal CAA’s determination.