



ACI EUROPE
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ACI EUROPE response to the UK Civil Aviation Authority's consultation CAP 2618

1. Introduction

ACI EUROPE welcomes the opportunity to respond to the consultation by the UK Civil Aviation Authority *Setting future price controls – review of approach*. In the wake of the biggest shock to the aviation industry, and after a four-year recovery to levels of activity last seen, the CAA's consultation comes at the right time and raises all of the key issues.

ACI EUROPE will challenge some of the UK CAA's approach, as we believe the aviation eco-system has undergone a fundamental and structural change, which requires an equally large shift in the thinking about economic regulation of airports.

The pricing determinations recently made in the United Kingdom, and across Europe, generate a significant amount of media attention. Much of the sound and fury in the pages of newspapers around Europe is no longer about the level of airport charges, though the airport is frequently blamed. It is more often driven by airlines seeking to gain advantages over their rivals at an airport through the structure of charges. Airports are offering more varied charges structures, because they are competing to win new air services, new airlines, more based aircraft, growth of existing customers, and higher passenger load-factors on services. This is indicative of a market with strong competitive aspects.

The UK CAA has demonstrated that the de-regulation of airports with tens of millions of passengers can happen and support airline customers, passengers, and airports. The gradual process of letting go of the grips of economic regulation in favour of more cost efficient and less antagonistic approaches is based in market realities and reflects the direction of competition in the airport market.

ACI EUROPE believes that consumers, airlines, airports and society benefit from economic regulation of airports that is based on governments ensuring conditions for competition between airports and allowing market dynamics to develop. Regulators should ensure that the framework they put in place puts first responsibility on airports to offer a service into the market based on consumers' current and future demands at a price that is determined by the market. Regulatory intervention should be targeted and seek to minimise frictions, rather than become a lightning rod for commercial frustrations. If regulatory intervention is justified, then it should be at the minimum level necessary to correct the market failure found.

2. Process, Mechanics and Governance

Market power assessments (2.17)

Observing the airport marketplace today, it is a varied landscape with a universe of airports serving different airlines, consumers, travellers, shippers, all of whom impose different demands on the airport, and have outside options. As a fixed, indivisible infrastructure asset, the airport operator implements a business plan to best serve that aggregated demand.

ACI EUROPE proposes that regulators such as the UK CAA conduct a broader assessment of the many facets of competition. These place significant pressure on Heathrow, and suggests that the CAA's initial approach on the HAL market power assessment should be reconsidered. We encourage economic regulators to take a fresh look at their own internalised biases and pre-conceptions about airport market power. Additional factors that merit consideration in assessments of market power are the countervailing power of airlines, the procurement forces of international airline groups, the coordination effects of joint-ventures and code-shares, and the airline service to facilitate hubbing through other competing global hubs, on the supply side. On the demand side, assessments must re-examine assumptions and input parameters around consumer behaviour and willingness to travel to alternative airports, use intermediary transport modes to switch airports, transfer passengers switching between hub airports, the rise of digital video-conferencing and metaverse platforms as substitutes to long-distance travel, and the facilitating role of technology in helping consumers find airport itineraries.

Complexity and time (2.23, 2.26, 2.41, 2.43)

One of the jarring features of the recent and upcoming price reviews is the duration of the process, with the process itself lasting almost as long as the regulatory period. Airport prices are being set on assumptions, facts, preconceptions, market conditions that exist years in advance of when the traveller sets foot in the airport or the airline takes-off from the airport.

In line with the development of the aviation eco-system, regulators should work to make the process more time efficient. The fundamental transparency principle of airport economics has gradually turned into a mechanism that means large parts of the airport operator's business decisions are open to consultation, scrutiny and debate with airlines and regulators, vastly increasing the time for reviews. Making the process time-efficient means focusing on potential problem areas, and decreasing involvement in other areas, for example capex planning or structure of charges.

The CAA and regulators across Europe should also allow more flexibility to the airport. In an age where airlines can adjust pricing daily and use continuous dynamic pricing to establish their price offer, the timelines for the review of airport charges are anachronistic. A solution would be to maintain the core framework of the quinquennium but to provide much more flexibility to the airport within the 5-year period.

The complexity of the approach is also seen in the new ex ante involvement of the UK CAA in oversight of CapEx programmes. The airport operator is best placed to determine its capital investment plan, and deploy that plan.

Constructive engagement (2.24) has demonstrated value. Indeed, ACI EUROPE's experience across Europe has shown that with regular discussions between airports and airlines, within the boundaries of consultations, better understanding of customers' needs and suppliers' options have reduced

frictions. Too often the regulator becomes the referee. The regulator should avoid ‘slicing down the middle’ between positions of two sides. Regulatory intervention should be targeted and seek to minimise frictions, rather than become a lightning rod for commercial frustrations. When regulatory intervention is justified, then it should be at the minimum level necessary to correct the market failure found.

Consumer views (2.32)

Consumer views are essential, and the CAA is right to ask this question. Airlines historically have been seen as speaking for the consumer, and often airlines have applied this ‘bundled consumer voice’ to push for lower airport charges. But only lower passenger service charges is not what airport customers expect, even if that is what airlines claim. In fact, recent surveys by Heathrow for H7 have shown that airport customers are willing to pay more for better service quality in the airport. Even under scrutiny and with the knowledge that passengers do not have a good understanding of what passenger service charges represent, it is still clear that passengers in many consumers groups are willing to pay more for higher service quality.¹

Innovations such as the consumer challenge board are useful, and can form one part of a number of measures to account for consumer views, but should not be considered exclusively. It should not be forgotten that airports already focus deeply on the consumer experience, measuring passenger satisfaction across many metrics.

Forecasts (2.35)

The inability of anyone – airlines, airports, regulators, consultants – to accurately predict passenger traffic reveals a fundamental problem with strict price regulation using building blocks, of which the denominator is a forecasted traffic volume.

It is not surprising that airports may take more conservative approaches on forecasting. The airport operator, especially in the wake of a crisis, must plan financially for the negative case, otherwise the risks of financial remediation costs are significantly elevated. Operationally, the operator must prepare for higher traffic volumes.

Traffic risk sharing mechanisms are tempting remedies for the weaknesses of forecasting. However, traffic risk sharing mechanisms are not magic solutions. During Covid-19, most regimes that had traffic risk sharing mechanisms saw the mechanism simply suspended (France, Denmark, Sweden), because application of the formula would have resulted in an unacceptable change to airport charges.

Recognising that all forecasts are imperfect, the question should be oriented away from one of whether to use internal or external forecasts. All forecasts are debatable and subject to hindsight.

The reflection on forecasts should be about how to make airports’ forecasts useful for regulation. It is the responsibility of airport operator to forecast and plan for that demand, and the forecast to be used should belong to the airport operator. Recognising the impossibility of forecasting to see the future, price controls need more margin for manoeuvre with the forecast.

¹ Review of Consumer Acceptability Testing Research, FTI Consulting, October 2021
[CAP2266F: Review of Consumer Acceptability Testing Research \(caa.co.uk\)](https://www.caa.co.uk/CAP2266F-Review-of-Consumer-Acceptability-Testing-Research)

Contribution to Net Zero (2.45)

ACI EUROPE is working with its members in the airport industry to implement airports commitments to achieving NetZero and reduced carbon emissions, providing a framework for mapping, measuring and reducing emissions.

Capital expenditure and investment by airport operators to reduce their scope 1 & 2 emissions should be treated like any other investment. There is no reason for the authority to carve out these investments and seek to disallow, refuse or reduce investment scope. Indeed, such oversight would send a very odd impression that independent supervisory authorities (ISAs) do not care about airports efforts to compete with other airports on environmental grounds, when that today is one of the most common means of competition between companies. At the meeting of the EU's Thessaloniki Forum on 7th September 2023, an airline representative stated airports use their environmental performance as one way to compete with other airports. Just as airlines invest in latest-generation aircraft and compete for consumers on that basis, airports in the business-to-business market can also compete on the basis of their environmental investment. Free competition is also the best way to ensure cost reduction in the industry at times when some other costs are rising (SAF, Corsia, crews, ATC, etc).

Cost of capital (2.48)

Regulators have customarily allowed airports a relatively low risk embodied in the WACC; and airports have generally been regarded as regulated assets carrying less risk than the stock market norm.

The Covid experience makes airports a fundamentally riskier proposition for equity investors. The market's and regulators' assessment of traffic risk will not have encompassed the scale and longevity of the Covid downturn, which has exceed 4 years. That is demonstrated by the marked movement in airport betas. Had Covid turbulence been within anticipated risk parameters such movement would have been more constrained. The crystallisation of a (previously theoretical) global pandemic risk, the potential for it to be devastating and prolonged and the greater sensitivity to the possibility of future global pandemics are all bound to affect equity investors' perceptions and appetites.

ACI EUROPE urges the CAA to assess the full implications of the pandemic on the calculation of the Beta for the Weighted Average Cost of Capital (WACC). The question is equally about the next unknown shock.

3. Broader strategic issues

The approach to airport regulation is often based on evidence 'in isolation' and argues for more general regulation. That way lies excessive and unnecessary regulation with attendant costs outweighing speculative benefits. The lesson from other approaches is that there needs to be both greater balance and more rigour in determining whether and to what extent regulation is required.

Discussion is too often conducted as though enhanced regulation is capable, without costs and side effects, of finessing market performance when the reality is that the evidence on which decisions are being made is inevitably uncertain and often subject to a wide margin of interpretation, that aviation markets are constantly evolving making for a moving target (as, for instance, with the continuing development of airport competition in Europe), and that the side effects of regulation are unclear, evolve and may be under-estimated because they are not immediately apparent.

More should be done to understand the spill-over effects of economic regulation, as hinted at in the discussion of scarcity rents in the consultation paper, and also the indirect effects, especially when airline pricing is not regulated but airport charges are regulated.

The implication of this approach to evidence and assessment is that the CAA should continue its reflections about the perfectability and costs of regulatory tools. A process for price controls for airports that is more time-efficient, less resource-intensive, and less contentious is possible, in line with the continued evolution of the UK CAA's approach to economic regulation of airports over the past decade. Such a step would enhance the perception of the industry and its regulators.

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