



[www.stopstanstedexpansion.com](http://www.stopstanstedexpansion.com)  
[info@stopstanstedexpansion.com](mailto:info@stopstanstedexpansion.com)

PO Box 311  
Takeley  
Bishops Stortford  
Herts CM22 6PY  
Tel: 01279 870558  
Fax: 01279 870786

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via post and email  
[David.Hart@dft.gsi.gov.uk](mailto:David.Hart@dft.gsi.gov.uk)

David Hart Esq  
Head of International Networks Analysis and Support  
Department for Transport  
1/26 Great Minster House  
76 Marsham Street  
London SW1P 4DR

Dear David

### **Reforming the framework for the economic regulation of UK airports**

Stop Stansted Expansion ('SSE') welcomes the opportunity to respond to this consultation on reforming the framework for the economic regulation of UK airports. This response should be read in conjunction with our submissions to Professor Martin Cave's review panel of 24 July 2008 and to Sir Joseph Pilling of 25 April 2008. You should have copies of both of these.

Our general position is that we agree that it is right to update the economic regulatory remit of the CAA which has been unchanged since the 1986 Airports Act and we support the principle of a licensing regime. We do however have major concerns about the proposed new statutory remit for the CAA.

Our response to each of your specific consultation questions is set out below:

***Q6.1 Does the proposed hierarchy of the duties – with a single primary duty supplemented by a set of further duties that the regulator should also consider when seeking to achieve its primary duty – provide sufficient certainty over the regulator's priorities? Are there alternative arrangements which would provide additional regulatory clarity?***

We do not agree that the interests of one particular group of airport stakeholders, namely, existing and future air passengers and freight users, should always be given absolute precedence over the interests of all other stakeholders.<sup>1</sup> Nor do we agree with your proposed clause (iv) which we regard as over-interventionist and likely to lead to the economic regulator simply becoming a tool of the Government of the day. Whilst there may be a case for close political direction of economic regulation in relation to the provision of essential public services such as the supply of water, electricity and gas we do not believe that the same justification can be applied to airport regulation where the economic regulator needs greater flexibility to

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<sup>1</sup> Is it correct, for example, that accommodating the late night departure of a group of revellers to Prague or the 3am arrival of an Ann Summers consignment from China should have legal precedence over the right of local families to have undisturbed sleep?

make judgements based on weighing the merits of the competing objectives of a wide range of stakeholders.

You ask for alternative suggestions and we would propose that, instead of replacing the whole of section 39 of the 1986 Airports Act with the remit proposed in para 6.8 of your consultation, sections 39(1) and 39(2) should remain in place and section 39(3) be amended as follows:

“(3) In performing those functions the CAA shall take into account:

- (a) such of the international obligations of the United Kingdom as may be notified to it by the Secretary of State for the purposes of this section;
- (b) the interests of existing and future consumers of passenger and freight services at UK airports, wherever appropriate by promoting effective competition;
- (c) the obligation upon licence holders, so far as is reasonably practicable<sup>2</sup>, to reduce and minimise the adverse impacts of activities connected with the provision of airport services upon the environment and local communities;<sup>3</sup>
- (d) the obligation upon licence holders to be able to finance the activities which are subject to the relevant licence obligations;<sup>4</sup>
- (e) National Policy Statements on airports, as published from time to time;
- (f) the principles of Better Regulation and any other principles appearing to represent the best regulatory practice;

and shall consult with the relevant stakeholders.”

**Q6.2 (a) Do you agree with the proposed primary duty? Do you have any comments on the drafting of the primary duty?**

We do not agree with the proposed primary duty for the reasons stated in our response to Q6.1. We have also suggested alternative drafting, as above.

**Q6.2 (b) Do you agree with the proposed approach of putting the passenger experience at the centre of the regulatory regime with additional rights for airlines and enhanced consumer representation?**

No, for the reasons stated in our response to Q6.1 above.

**Q6.2 (c) Is promoting effective competition the best way to promote the interests of consumers of airport services?**

Yes, as per our response to Q6.1 above.

**Q6.3 [a]<sup>5</sup> Do you agree that it is appropriate for the economic regulator of airports to have regard to environmental limits?**

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<sup>2</sup> The term 'so far as is reasonably practicable' is well established in law, for example, it lies at the heart of the Health and Safety at Work Act 1974.

<sup>3</sup> This obligation would be defined elsewhere in the amending legislation.

<sup>4</sup> As above.

<sup>5</sup> We have subdivided Q6.3 into a, b and c.

If the economic regulator is to have any meaningful environmental responsibility there needs to be (a) an obligation upon airport operators, as a licensing condition, “so far as is reasonably practicable, to reduce and minimise the adverse impacts of activities connected with the provision of airport services upon the environment and local communities” and (b) an obligation upon the regulator to ensure compliance with this licensing condition. This approach would enable the regulator’s environmental responsibilities to be dovetailed into the system of economic regulation.

Airport operators are themselves currently responsible for monitoring and reporting upon the environmental impacts of their operations as well as for the levying and collection of any fines imposed upon aircraft operators who breach the rules. They are also largely responsible for setting their own environmental limits with a few exceptions where local planning conditions and Government regulation provide constraints. However, it is, in essence, a system of self-regulation and this has given rise to considerable mistrust amongst local communities in relation to the fairness, objectivity and transparency of the current arrangements. The need for proper environmental regulation of airports is long overdue and this should be undertaken by an independent body with a clear statutory remit.

**Q6.3 [b] Does the proposed duty provide sufficient clarity over the respective roles of the Government and the CAA?**

No, the environmental role that you propose for the CAA is too vague. We propose a more clearly defined role for the CAA based on a licensing condition along the lines proposed in our response to Q6.3[a] above and an obligation upon the CAA to ensure compliance with this.

If, however, it was considered impractical or inappropriate to give the CAA an environmental role alongside its economic regulatory role, a separate ‘watchdog’ body, such as the Environment Agency, could be charged with ensuring that airport operators complied with the licensing condition that we propose at 6.3 [a] above. Under such an arrangement the CAA would retain the responsibility for licensing but would rely upon the advice of the Environment Agency as to whether the airport operator had complied with the licensing condition relating to environmental protection, i.e. “so far as is reasonably practicable, to reduce and minimise the adverse impacts of activities connected with the provision of airport services upon the environment and local communities.”

**Q6.3 [c] Does the proposed duty risk compromising the clarity of the regulator’s primary duty?**

As stated in our response to Q6.1, we do not agree that the regulator should have a duty to promote the interests of air passengers and users of freight services above all other interests. We believe that it is perfectly feasible for the regulator to strike a balance between a range of statutory duties even where these duties give rise to conflicting objectives. A balanced approach (the declared cornerstone of the policies set down in the ‘Future of Air Transport’ White Paper (‘ATWP’) <sup>6</sup>) necessarily means compromising between the interests of different stakeholders and would be more complex and challenging for the regulator. However our view is that this would result in better decisions than the over-simplistic approach which you propose.

**Q6.4 Given the proposed primary duty to promote the interests of consumers, is it necessary to have a further duty to ensure that all reasonable demands are met efficiently?**

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<sup>6</sup> The phrase ‘measured and balanced’ is used no fewer than six times in the ATWP, underlining the importance of striking a balance between the economic and social importance of air transport and its adverse impacts upon the environmental and communities.

Again, we do not agree that the regulator should be legally obliged to promote the interests of air passengers and users of freight services above all other interests. In addition, the use of the word 'efficiently' in this context could be taken to mean 'at minimum cost to consumers' and thereby discourage the regulator from taking into account other relevant factors.

**Q6.5 Given the proposed primary duty to promote the interests of consumers, is a further financing duty required?**

Again, we do not agree that the regulator should have a duty to promote the interests of air passengers and users of freight services above all other interests. We do however agree that there is a case for a financing duty and we have included this in our alternative proposal in our response to Q6.1 above.

**Q6.6 What is the appropriate interpretation of a financing duty in the airports sector?**

There should be a statutory duty upon licence holders to be able to finance the activities which are subject to the relevant licence obligations, along the lines we propose as new section 39(3)(d) of the Airports Act, as set out in our response to Q6.1 above. The CAA should be responsible for ensuring compliance with this. See also our response to Q9.6 (below).

**Q6.7 Does the proposed duty provide the right balance between the roles of the Government and the CAA?**

This question relates to your proposed duty upon the CAA "*to take account of guidance issued by the Secretary of State, and to assist in delivery of airport infrastructure consistent with the National Policy Statement on Airports unless there are compelling reasons not to do so*". We certainly do not believe that this would provide the right balance between the roles of the Government and the CAA. Indeed we are dismayed that you are proposing a far more interventionist approach than even that proposed by Professor Martin Cave's review panel. As stated in our response to Q6.1 above, we consider that the approach that you propose is likely to lead to the economic regulator simply becoming a tool of the Government of the day.

We have dealt with the other elements of this question in our response to Q6.1 above.

**Q7.1 Do stakeholders agree with the proposed approach to developing a new licensing regime for airports?**

Yes, including the proposed tiers, criteria and thresholds. We also agree that the criteria for determining whether an airport has a Tier 1 licence should be defined in primary legislation and that the CAA should have the flexibility to regulate small airports in the event of evidence emerging that they were abusing their local market power. We believe it should be left to the CAA to decide how best to intervene in such circumstances subject to a general obligation that regulation should be proportionate and the right of the airport operator to appeal.

**Q7.2 Do you agree with the principle of using the proposed licence regime for the economic regulation of airports to implement certain aspects of the Airport Charges Directive?**

Yes, this is a commonsense approach.

**Q7.3 We would welcome comments on these initial thoughts about the conditions that should be included in the licence for each tier.**

At this stage we simply identify the two obligations referred to in our proposed amendment to section 39(3) of the 1986 Airport Act:

- Tier 1, 2 and 3 licences should contain an obligation upon licence holders, so far as is reasonably practicable, to reduce and minimise the adverse impacts of activities connected with the provision of airport services upon the environment and local communities;

- Tier 1 and 2 licences should contain an obligation upon licence holders to be able to finance the activities which are subject to the relevant licence obligations.

**Q7.4 We view the introduction of the proposed licensing regime as being beneficial to consumers although we understand that there will be associated implementation costs. What do you think the likely scale and value of these costs will be?**

We are not in a position to answer this question other than to express the view that we would not expect the implementation costs to be significant and therefore we would not expect them to be a deterrent to the introduction of a licensing regime.

**Q7.5 We would welcome comments on the proposed process for changes to licence conditions. We would particularly welcome comments on the proposed process for collective licence modifications.**

- **Do you agree that in a reformed regulatory regime the Secretary of State should retain the right to refer changes to licence conditions, even where agreed by the licensee, to the Competition Commission? Is this an appropriate scope for an intervention power for the Secretary of State?**

Yes. This appears to us to be an appropriate power which would strengthen the 'checks and balances' element of the proposed new arrangements.

- **Do you agree that where a proposed change of licence condition would apply identically to a group of airports that this change would come into effect if it was accepted by 80% of these airports representing 80% of total passenger numbers across the group?**

No, because a high level of industry consensus could reflect changes which were in the interests of airport operators but at the expense of the interests of other stakeholders.

**Q7.6 Do you agree with the proposals to put in place similar provisions for sanctions and enforcement by the CAA for the airports sector that apply in the other main regulated sectors in the UK? Are there any particular features of the airports sector that would justify or require a different approach to licence revocation?**

We do not have a view on this question except to say that we would be very wary about drawing analogies between the airports sector and the utilities sector or even the rail sector because there are many features of the airports sector which are quite different in character.

**Q7.7 Do you agree that the CAA should have concurrent competition law powers for airport services in the UK?**

No, we believe that separation of the regulatory roles of the Office of Fair Trading, Competition Commission and CAA should be maintained in the interests of ensuring checks and balances.

**Q8.1 We would welcome views on the proposed approach to allowing appeals regarding CAA decisions about whether an airport should have a Tier 1 licence and regarding licence modifications. We would particularly welcome comments on which parties should have the right to appeal and on which decisions particular parties should have the right to appeal. We would also welcome views on the most appropriate approach to ensure that appeals are neither frivolous nor vexatious.**

We note that organisations representing environmental interests and/or the interests of local communities are not included in your list of parties who you propose should be allowed to appeal a CAA decision either in relation to a Tier 1 licence or in relation to licence modifications. Even in the case of licence modifications, these might include a weakening of the required environmental standards, the safeguards for local communities or both. We

therefore believe that local authorities and organisations representing community or environmental interests, such as ourselves, should have the right of appeal in both situations.

To prevent frivolous or vexatious appeals, the CAT should, as you propose and at its own discretion, have the power to make costs awards in respect of its own costs and those of any third party involved where an appeal is deemed to be frivolous or vexatious. In the event of any party feeling aggrieved about a CAT costs award, there should be the right to appeal this to the High Court.

***Q8.2 Do you agree with the proposal that the CAA would be required to consider the regulatory status of a Tier 1 airport at the end of each price control period (the sunset clause)?***

Yes, this seems a reasonable approach. We also agree with your proposal that CAA decisions about whether an airport should have a Tier 1 licence should be subject to a merits based appeal to the CAT. With regard to who should have the right to appeal a CAA decision about whether an airport should have a Tier 1 licence, we say again that local authorities and organisations representing community or environmental interests should be included and that the right of the CAT to make costs awards should be an adequate deterrent to frivolous or vexatious appeals.

***Q8.3 As set out at the beginning of this section, we would welcome stakeholders' comments on how the right of appeal on licence condition changes should be framed.***

Our strong preference is for Option 1 and, as stated above, local authorities and organisations representing community or environmental interests should have the right of appeal in the event of the changes to the licence conditions adversely affecting or being likely to adversely affect the environmental impact of the airport and/or its impact upon local communities.

***Q8.4 Does a procedure which involves either the agreement of the licensee only or a determination of the public interest by the Competition Commission properly take account of airline and other third party views?***

Clearly not.

***Q8.5 Should airlines and other third parties have a specific right to be consulted on proposed licence modifications?***

Yes. Consultation prior to any licence modifications would be in everyone's interests and should reduce the likelihood of appeals.

***Q8.6 Do you agree that Tier 1 and 2 airports should be required to submit an annual report to the CAA and other environmental regulators about their environmental performance? Are there any specific requirements that you consider should be in such a licence condition?***

We believe that Tier 3 airports should also be required to submit an annual report on their environmental performance although in simplified form compared to Tier 2 airports and Tier 1 airports should be required to submit a more comprehensive report than Tier 2 airports.

Specifying the precise content of these reports will be a major task and one which we are not currently in a position to undertake. We would find it helpful if the DfT produced drafts which outlined the range of environmental and local community impacts which it would expect airport operators to report on each year. We would then be happy to comment.

Simply publishing an annual environmental report, of course, does nothing in itself to reduce and minimise the adverse environmental and community impacts of an airport. There needs to be an obligation upon licence holders, so far as is reasonably practicable, to reduce and

minimise the adverse impacts of activities connected with the provision of airport services upon the environment and local communities. The CAA would be charged with ensuring that this licensing condition was met (as per our proposed section 39(3)(c), set out in response to Q6.1 above) and we would expect the CAA to act in a monitoring role and to set reasonable improvement targets in order to fulfil that duty.

**Q8.7 The Government is considering applying the Compliance Code to CAA's economic functions. Are you in favour of extending the coverage of the Code in this way? Please give reasons to support your views.**

We do not have a view on this matter.

**Q9.1 What specific information gathering powers will the regulator need to facilitate an effective Constructive Engagement process? What information do airlines require to empower them to influence investment programmes in the interests of consumers?**

These are questions for the CAA, relevant airport operators and the airlines to answer.

**Q9.2 Is there a need for the CAA to consider extending SQRs beyond those activities under the direct control of the airport operator? What would be an appropriate mechanism for doing so?**

These are questions for the CAA, relevant airport operators and the airlines to answer.

**Q9.3 How could the SQR metrics be changed to provide a better fit to the outcomes that affect passengers' experience. Should someone other than BAA monitor the SQR metrics?**

These are questions for the CAA, relevant airport operators (not just BAA) and the airlines to answer.

**Q9.4 How might incentives upon airport operators to deliver appropriate levels of service quality be improved in the new regime to produce better outcomes for consumers?**

No comment except to recommend that any improvement of incentives should also consider how to produce better outcomes for local communities or the environment, and should certainly not seek improvements to service quality at the expense of the community or the environment.

**Q9.5 We would welcome comments both on the merits of allowing terminal competition and the best way for the regulatory framework to permit such competition.**

No comment.

**Q9.6 The DfT would welcome the feedback of stakeholders on the issues raised relating to airports' financial resilience, in particular:**

- **Should the DfT introduce a Special Administration regime for the airports industry?**

If the Government believes that an airport is of strategic importance to the UK economy then it follows that, in the event of that airport getting into financial difficulty, the Government would want to have the power to appoint a Special Administrator to protect the national interest. The primary statutory duty of a normal commercial administrator would be to creditors, not to customers nor to protect the national interest.

- **Are airports sufficiently important assets for the Government to take steps to ensure their continued operation? If the Government were to introduce Special Administration for airports how should this be designed and implemented? Do you**

***believe that a staged implementation of the Special Administration regime over a period of time would be helpful?***

The Government has repeatedly stated that Heathrow and other large UK airports are of vital importance to the UK economy. Based on this belief, it would be a dereliction of duty if the Government did not wish to have the power to appoint a Special Administrator. We have no strong views as to whether the Special Administrator should be appointed by the Secretary of State (on advice from the economic regulator) or directly by the economic regulator.

***• Should the regulatory regime be reformed to allow the regulator to introduce licence conditions to ring-fence regulated assets?***

Yes, at the regulator's discretion.

***• Should the regulatory regime be reformed to allow the regulator to introduce licence conditions obliging regulated businesses to maintain an investment-grade credit rating and if so in what form?***

We believe that the regulator should have a duty to require an airport operator to maintain an investment-grade rating. We consider that the maintenance of an S&P rating of BBB- or above should be obligatory and this should be the assumption used in the regulator's assessment of the allowable weighted average cost of capital ('WACC'). We would also recommend that the allowable WACC should in future be assessed on a post-tax, not pre-tax, basis.

***• How might such provisions be introduced to minimise disturbance to existing financing arrangements?***

Clearly there would need to be transitional arrangements with a defined deadline for meeting the required criteria and the CAA needs to have the power of the last resort to revoke the licence if the required criteria are not satisfied by a defined date. A five year transition period would seem appropriate. However the regulator should be specifically prohibited from allowing an additional increase in airport charges during the transition period for the purposes of repairing the airport operator's balance sheet. In other words, if the legacy balance sheet is weak, the airport operator must use his own resources to remedy this.

***Q10.1 Do you agree with the proposal to give Passenger Focus responsibility for consumer policy advocacy with regards to airlines and airports, funded through airport licence fees? In particular, we welcome views on the proposal for Passenger Focus to develop and support a network of consumer panels at leading airports.***

***Q10.2 Do you agree with the proposal to give Passenger Focus responsibility for complaints handling on airline and airport issues alongside its policy advocacy function? How can we best ensure the expertise and sector knowledge in relation to EU air passenger rights built up over time by the AUC is retained?***

We do not have a view on these matters.

We hope you find our comments helpful.

Yours sincerely



Brian Ross  
for Stop Stansted Expansion