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|--|--|--|--|--|
| Title: Reforming the framework for the economic regulation of airports IA No: DFT00005 Lead department or agency: Department for Transport Other departments or agencies: None | Impact Assessment (IA) | | | |
| | Date: 6/01/2012 | | | |
| | Stage: Final | | | |
| | Source of intervention: Domestic | | | |
| | Type of measure: Primary legislation | | | |
| | Contact for enquiries: robert.catherall@dft.gsi.gov.uk | | | |

| | |
|--|---------------------------|
| Summary: Intervention and Options | RPC Opinion: AMBER |
|--|---------------------------|

| Cost of Preferred (or more likely) Option | | | |
|---|----------------------------|--|---|
| Total Net Present Value | Business Net Present Value | Net cost to business per year (EANCB on 2009 prices) | In scope of One-In, Measure qualifies as One-Out? |
| £160m | NQ | NQ | Yes OUT |

What is the problem under consideration? Why is government intervention necessary?

UK airports with substantial market power are subject to economic regulation if the threat of competition law is not sufficient to address the risk that these airports may abuse their power by exploiting passengers. Evidence indicates that there is at least one airport (Heathrow) that will continue to have substantial market power. Evidence from consultations show that industry and the regulator believe the current regime to be disproportionate, inflexible and in need of reform. The Competition Commission has concluded that the current legislative framework distorts competition between airlines by adversely affecting the level, specification and timing of investment and the appropriate level and quality of service to passengers and airlines.

What are the policy objectives and the intended effects?

The aim of economic regulation is to replicate the outcomes of a competitive market (e.g. price, service quality, choice and reliability). By giving the airport regulator a clearer objective, a more effective set of regulatory tools and making its decisions more accountable, we aim to further reduce levels of consumer detriment by:

- improving outcomes so they more closely replicate the outcomes of a competitive market; and
- reducing the distortionary effects of economic regulation (by removing regulation where it's no longer necessary and removing unnecessary political involvement and bureaucracy from the regulatory process).

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 0: Do nothing - retain the current regime as set out in Part IV of the 1986 Airports Act.
Option 1a: A package of regulatory reforms including clearer duties for the regulator; a flexible licensing regime; a proportionate enforcement regime; concurrent competition powers and greater accountability of regulatory decisions (including rights to challenge airport licence modifications for the airport operator only).
Option 1b: Same as option 1a but rights to challenge for airport operator and Secretary of State.
Option 1c: Same as option 1a but rights to challenge for airport operator and a consumer body.
Option 1d (preferred option): Same as option 1a but rights to challenge for airport operator and airlines.
Option 1e: Same as option 1a but rights to challenge for airport operator, airlines and a consumer body.
Note, there is a different form of challenge for options 1d and 1e to options 1a, 1b and 1c.

| | | | | | |
|--|--------------------|----------------------|-----------------------|---------------------|---------------------------|
| Will the policy be reviewed? It will be reviewed. If applicable, set review date: 04/2019 | | | | | |
| Does implementation go beyond minimum EU requirements? | | | N/A | | |
| Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base. | Micro No | < 20 No | Small No | Medium No | Large No |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | Traded: N/A | | Non-traded: N/A |

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:  Date: 9th Jan 2012

Summary: Analysis & Evidence

Policy Option 1a

Description: Duties reflecting passenger interests; a licensing regime; an enforcement regime and a new appeals system. Rights to challenge licence modifications via an investigation for the airport operator only.

FULL ECONOMIC ASSESSMENT

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|----------------------|-------------------|----------------------|---------------------------------------|-------------|----------------------|
| | | | Low: -68.3 | High: 927.5 | Best Estimate: 163.7 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low | 0.2 | 0.5 | 7.5 |
| High | 1.2 | 5.1 | 74.1 |
| Best Estimate | 0.6 | 2.1 | 31.1 |

Description and scale of key monetised costs by 'main affected groups'

Total additional CAA resources (£16.4m).

Costs of challenges: airport operator (licensee) (£5.2m); Competition Appeal Tribunal (£2.1m); Competition Commission (£3.1m); Appellants (licence operator) (£2.8m); appeal interveners (£1.4m).

We anticipate that the majority of these costs (at least 93.1%) will eventually be passed on to passengers. The remainder (at most 6.9%) is incurred by either the DfT or the CAT. See paragraph 26 for details.

Other key non-monetised costs by 'main affected groups'

Some stakeholders, in particular airlines, believe this option would lead to unbalanced negotiations and increase the risk of regulatory capture. Licence modifications which favour the airport at the expense of passengers would not be challenged. The empirical evidence on whether such risks could materialise is inconclusive; but the scale of the impact if such risks do materialise is potentially significant.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low | 0 | 0.4 | 5.8 |
| High | 0 | 65.8 | 934.9 |
| Best Estimate | 0 | 13.7 | 194.8 |

Description and scale of key monetised benefits by 'main affected groups'

Overall benefits: operating and capital expenditure efficiencies and reduction in cost of capital (£174.6m).

Removal of automatic references to the Competition Commission on price controls (£17.4m).

Other resource savings associated with the new regime (£2.8m).

We anticipate that the vast majority of these benefits (99.6%) will be passed on to passengers, for example through lower prices and/or higher service quality, The remainder (0.4%) is realised by DfT.

Other key non-monetised benefits by 'main affected groups'

None

| | | |
|--|--------------------------|-----|
| Key assumptions/sensitivities/risks | Discount rate (%) | 3.5 |
| <p>The impact of the new regulatory framework is hard to predict, since it will be for the CAA to determine regulatory outcome, so we use several assumptions to illustrate the scale of the costs and benefits. The large range for the NPV partly reflects this uncertainty but is also because small efficiency savings are applied to large cost bases. The regulator agrees these are sensible assumptions, and many were tested with stakeholders. A 20 year appraisal period is chosen (see annex 7).</p> | | |

BUSINESS ASSESSMENT (Option 1a)

| | | |
|--|--------------------------|-----------------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OIOO? | Measure qualifies as |
| Costs: NQ Benefits: NQ Net: NQ | Yes | OUT |

Summary: Analysis & Evidence

Policy Option 1b

Description: The same as option 1a except the rights to challenge licence modifications via an investigation is extended to the Secretary of State as well as the airport operator (licensee).

FULL ECONOMIC ASSESSMENT

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|----------------------|-------------------|----------------------|---------------------------------------|-------------|----------------------|
| | | | Low: -92.7 | High: 925.0 | Best Estimate: 154.1 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low | 0.2 | 0.7 | 9.9 |
| High | 1.2 | 6.8 | 98.5 |
| Best Estimate | 0.6 | 2.8 | 40.6 |

Description and scale of key monetised costs by 'main affected groups'

Total additional CAA resources (£16.7m). DfT licence modifications monitoring costs (£4.4m)
 Appeals and objections costs: airport operator (£8.1m); Competition Appeal Tribunal (£2.1m); Competition Commission (£4.8m); appellants (licensee and Secretary of State) (£3.1m); appeal interveners (£1.4m)
 We anticipate that the majority of these costs (at least 84.1%) will be passed on to the passenger. The remainder (at most 15.9%) is incurred by either DfT or the CAT. See paragraph 26 for details

Other key non-monetised costs by 'main affected groups'

Some stakeholders believe the prospect of politically motivated objections could create some regulatory uncertainty.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low | 0 | 0.4 | 5.8 |
| High | 0 | 65.8 | 934.9 |
| Best Estimate | 0 | 13.7 | 194.8 |

Description and scale of key monetised benefits by 'main affected groups'

Overall benefits: operating and capital expenditure efficiencies and reduction in cost of capital (£174.6m).
 Removal of automatic references to the Competition Commission on price controls (£17.4m).
 Other resource savings associated with the new regime (£2.8m).
 We anticipate the vast majority of these benefits (99.6%) will be passed on to passengers, for example through lower prices and/or higher service quality. The remainder (0.4%) is realised by DfT .

Other key non-monetised benefits by 'main affected groups'

This option could make CAA licence modification decisions more accountable to passengers. However, stakeholders generally do not believe this will be the case.

| | | |
|---|--------------------------|-----|
| Key assumptions/sensitivities/risks As for option 1a. | Discount rate (%) | 3.5 |
|---|--------------------------|-----|

BUSINESS ASSESSMENT (Option 1b)

| | | |
|--|--------------------------|-----------------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OIOO? | Measure qualifies as |
| Costs: NQ Benefits: NQ Net: NQ | Yes | OUT |

Summary: Analysis & Evidence

Policy Option 1c

Description: The same as option 1a except the right to object to licence modifications via an investigation is extended to a passenger representative body as well as the airport operator (licensee).

FULL ECONOMIC ASSESSMENT

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|----------------------|-------------------|----------------------|---------------------------------------|-------------|----------------------|
| | | | Low: -98.9 | High: 924.5 | Best Estimate: 152.0 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low | 0.2 | 0.7 | 10.4 |
| High | 1.2 | 7.3 | 104.7 |
| Best Estimate | 0.6 | 3.0 | 42.8 |

Description and scale of key monetised costs by 'main affected groups'

Total additional CAA resources (£16.9m). Consumer body monitoring costs (£3.0m)
 Appeals and objections costs: airport operator (£9.9m); Competition Appeal Tribunal (£2.1m); Competition Commission (£6.0m); appellants (licensee and consumer body) (£3.4m); appeal interveners (£1.4m).
 We anticipate that the majority of these costs (at least 95.0%) will be passed on to the passenger. The remainder (at most 5.0%) is incurred by either DfT or the CAT. See paragraph 26 for details.

Other key non-monetised costs by 'main affected groups'

We assume that there are a greater number of licence modification challenges under this option than options 1a and 1b. It is unclear whether the prospect of a greater number of challenges could generate regulatory uncertainty.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low | 0 | 0.4 | 5.8 |
| High | 0 | 65.8 | 934.9 |
| Best Estimate | 0 | 13.7 | 194.8 |

Description and scale of key monetised benefits by 'main affected groups'

Overall benefits: operating and capital expenditure efficiencies and reduction in cost of capital (£174.6m).
 Removal of automatic references to the Competition Commission on price controls (£17.4m).
 Other resource savings associated with the new regime (£2.8m).
 We anticipate the vast majority of these benefits (99.6%) will be passed on to passengers, for example through lower prices and/or higher service quality, The remainder (0.4%) is realised by DfT.

Other key non-monetised benefits by 'main affected groups'

This option could make CAA licence modification decisions more accountable to passengers, but stakeholders differ markedly in their views on whether and to what extent this will be the case. In the absence of an independent air passenger representative body and given uncertainty about Consumer Focus' future, it is not clear which consumer body (if any) would be well placed to take on this role.

Key assumptions/sensitivities/risks

As for option 1a and there is also significant uncertainty whether a suitable existing consumer body can be identified to take on these functions - both in the medium term as well as in time for the next price controls (work on which has already begun).

Discount rate (%) 3.5

BUSINESS ASSESSMENT (Option 1c)

| | | |
|---|-------------------|----------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OIOO? | Measure qualifies as |
| Costs: NQ Benefits: NQ Net: NQ | Yes | OUT |

Summary: Analysis & Evidence

Policy Option 1d

Description: Preferred Option: Same as option 1a except the right to object to licence modifications is given to airlines as well as the airport operator and the form of challenge is an appeal rather than an investigation.

FULL ECONOMIC ASSESSMENT

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|-------------------------|----------------------|-------------------------|---------------------------------------|-------------|----------------------|
| | | | Low: -75.5 | High: 927.5 | Best Estimate: 160.0 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|---|-------------------------------|
| Low | 0.2 | 0.5 | 7.5 |
| High | 1.2 | 5.6 | 81.2 |
| Best Estimate | 0.6 | 2.4 | 34.8 |

Description and scale of key monetised costs by 'main affected groups'

Total additional CAA resources (£19.2m).

Appeals and objections costs: appeal interveners (licensee and airlines) (£4.7m); Competition Appeal Tribunal (CAT) (£2.1m); Competition Commission (£3.3m); appellants (licensee and airlines) (£5.4m).

We anticipate that the majority of these costs (at least 93.9%) will be passed on to the passenger. The remainder (at most 6.1%) is incurred by either DfT or the CAT. See paragraph 26 of the full IA for detail.

Other key non-monetised costs by 'main affected groups'

Some stakeholders are concerned that if this option led to numerous appeals it could create regulatory risk. Although the number of appeals is likely to be higher than for other options, the design of the system should deter speculative appeals and help to reduce the level of regulatory risk.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|---|----------------------------------|
| Low | 0 | 0.4 | 5.8 |
| High | 0 | 65.8 | 934.9 |
| Best Estimate | 0 | 13.7 | 194.8 |

Description and scale of key monetised benefits by 'main affected groups'

Overall benefits: operating and capital expenditure efficiencies and reduction in cost of capital (£174.6m).

Removal of automatic references to the Competition Commission on price controls (£17.4m).

Other resource savings associated with the new regime (£2.8m).

We anticipate the vast majority of these benefits (99.6%) will be passed on to passengers, for example through lower prices and/or higher service quality. The remainder (0.4%) is realised by DfT.

Other key non-monetised benefits by 'main affected groups'

This option should make CAA decisions on licence modifications more accountable than under options 1a, 1b and 1c.

| | | |
|---|--------------------------|-----|
| Key assumptions/sensitivities/risks As for option 1a. | Discount rate (%) | 3.5 |
|---|--------------------------|-----|

BUSINESS ASSESSMENT (Option 1d)

| | | |
|--|--------------------------|-----------------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OIOO? | Measure qualifies as |
| Costs: NQ | Yes | OUT |
| Benefits: NQ | | |
| Net: NQ | | |

Summary: Analysis & Evidence

Policy Option 1e

Description: Same as option 1a except the right to object to licence modifications is extended to airlines, a consumer body as well as the airport operator and the form of challenge is an appeal rather than an investigation.

FULL ECONOMIC ASSESSMENT

| Price Base Year 2010 | PV Base Year 2011 | Time Period Years 20 | Net Benefit (Present Value (PV)) (£m) | | |
|----------------------|-------------------|----------------------|---------------------------------------|-------------|----------------------|
| | | | Low: -78.4 | High: 924.5 | Best Estimate: 157.0 |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low | 0.2 | 0.7 | 10.4 |
| High | 1.2 | 5.8 | 84.2 |
| Best Estimate | 0.6 | 2.6 | 37.8 |

Description and scale of key monetised costs by 'main affected groups'

Total additional CAA resources (£19.2m).

Appeals and objections costs: appeal interveners (licensee and airlines) (£4.7m); Competition Appeal Tribunal (£2.1m); Competition Commission (£3.3m); appellants (licensee and airlines) (£5.4m).

We anticipate that the majority of these costs (at least 93.9%) will be passed on to the passenger. The remainder (at most 6.1%) is incurred by either DfT or the CAT. See paragraph 26 for detail.

Other key non-monetised costs by 'main affected groups'

Some stakeholders are concerned that if this option led to numerous appeals it could create regulatory risk. Although the number of appeals is likely to be higher than for other options, the design of the system should deter speculative appeals and help to reduce the level of regulatory risk.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low | 0 | 0.4 | 5.8 |
| High | 0 | 65.8 | 934.9 |
| Best Estimate | 0 | 13.7 | 194.8 |

Description and scale of key monetised benefits by 'main affected groups'

Overall benefits: operating and capital expenditure efficiencies and reduction in cost of capital (£174.6m).

Removal of automatic references to the Competition Commission on price controls (£17.4m).

Other resource savings associated with the new regime (£2.8m).

We anticipate the vast majority of these benefits (99.6%) will be passed on to passengers, for example through lower prices and/or higher service quality, The remainder (0.4%) is realised by DfT.

Other key non-monetised benefits by 'main affected groups'

This option should make CAA decisions on licence modification more accountable than under any other option, although it is unclear whether the incremental benefit to option 1d of increased accountability is significant or not.

| | | |
|--|--------------------------|-----|
| Key assumptions/sensitivities/risks | Discount rate (%) | 3.5 |
| As for option 1a. | | |

BUSINESS ASSESSMENT (Option 1e)

| | | |
|--|--------------------------|-----------------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OIOO? | Measure qualifies as |
| Costs: NQ Benefits: NQ Net: NQ | Yes | OUT |

Enforcement, Implementation and Wider Impacts

| | | |
|--|--------------------------------|-------------------------|
| What is the geographic coverage of the policy/option? | United Kingdom | |
| From what date will the policy be implemented? | 01/04/2014 | |
| Which organisation(s) will enforce the policy? | Civil Aviation Authority (CAA) | |
| What is the annual change in enforcement cost (£m)? | 0.3 | |
| Does enforcement comply with Hampton principles? | Yes | |
| Does the proposal have an impact on competition? | Yes | |
| What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable? | Costs: 100 | Benefits: 100 |

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

| Does your policy option/proposal have an impact on...? | Impact | Page ref within IA |
|---|--------|--------------------|
| Statutory equality duties ¹ Statutory Equality Duties Impact Test guidance | No | 63 |
| Economic impacts | | |
| Competition Competition Assessment Impact Test guidance | Yes | 65 |
| Small firms Small Firms Impact Test guidance | No | 63 |
| Environmental impacts | | |
| Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance | No | 66 |
| Wider environmental issues Wider Environmental Issues Impact Test guidance | No | 67 |
| Social impacts | | |
| Health and well-being Health and Well-being Impact Test guidance | No | 63 |
| Human rights Human Rights Impact Test guidance | No | 67 |
| Justice system Justice Impact Test guidance | No | 64 |
| Rural proofing Rural Proofing Impact Test guidance | No | 64 |
| Sustainable development Sustainable Development Impact Test guidance | No | 66 |

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

| No. | Legislation or publication |
|-----|--|
| 1 | Post consultation IA (December 2009) published by the previous Government.. http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationukairports/decisiondocument/ |
| 2 | Consultation IA (March 2009) http://www.dft.gov.uk/consultations/archive/2009/ukairports/ |
| 3 | Airports Act 1986 http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1986/cukpga_19860031_en_1 |

Evidence Base

Annual profile of monetised costs and benefits* - (£m) constant prices – Option 1d

| | Y ₀ | Y ₁ | Y ₂ | Y ₃ | Y ₄ | Y ₅ | Y ₆ | Y ₇ | Y ₈ | Y ₉₋₂₀ |
|---------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-------------------|
| Transition costs | 0 | 0.6 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Annual recurring cost | 0 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Total annual costs | 0 | 3.0 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Transition benefits | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Annual recurring benefits | 0 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 |
| Total annual benefits | 0 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 | 13.7 |

* For non-monetised benefits please see summary pages and main evidence base section

The table above sets out the annual profile of monetised costs and benefits for the preferred option (option 1d). Note the final column displays the annual profile for each of the final 12 years, since these costs are identical for each of these years. Annex 3 provides the annual profiles for the other three options: option 1a, 1b, and 1c. In practice some of the on-going costs (e.g. those associated with the number of proposed licence modifications and the number of objections to the licence modifications) will be lumpy. However, due to the fact that it is difficult to predict in advance when exactly such costs would be incurred the table above and the tables in annex 3 smooth the on-going costs over the 20 year appraisal period.

