



Aviation: airport regulation

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This note sets out the regulatory framework at UK airports, including recent reforms in the *Civil Aviation Act 2012*, and explains the role of the regulator, the CAA.

The 2012 Act introduced a new regulatory regime at the UK's major airports (in the event only Heathrow and Gatwick), based on assessment of market power and focused on the interests of passengers and airports' customers (airlines etc.). These changes were the culmination of several years of consultation by both the previous Labour and present Coalition governments.

Further information on aviation matters can be found on the [Aviation Topical Page](#) of the Parliament website.

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1 A brief history of the CAA and airport regulation

In 1967 the President of the Board of Trade set up a committee to look into “the economic and financial situation and prospects of the British civil air transport industry”.¹ The committee was chaired by Sir Ronald Edwards who was then Chairman of the Beecham Group and was formerly Chairman of the Electricity Council; the Committee has thus generally been referred to as the Edwards Committee. The Committee reported to the President of the Board of Trade, Antony Crosland, in May 1969. It set out how the civil aviation sector operated at that time and proposed reforms. In the late 1960s the various civil aviation duties (for regulating airports, managing air traffic control and en route navigation) were divided between the Air Transport Licensing Board (ATLB); various branches of the Board of Trade, including the Director General of Safety Operations (who was statutorily responsible for aviation safety); and the Air Registration Board.² The Committee took a view that there was a strong case for rationalising these functions and looked at four possible methods of achieving this.³ Ultimately, the Committee recommended that an independent, statutory ‘civil aviation authority’ should be set up.⁴ The report concluded:

There are interlocking relationships between the economic, technological and operational aspects of regulation and this should be recognised by bringing them under the auspices of one body. We have therefore concluded that all these functions, together with the forward planning of the infrastructure, including airports, should be concentrated in one new Civil Aviation Authority.⁵

In November 1969 the Labour Government published its White Paper on civil aviation policy. This accepted the Edwards Commission’s recommendation for a civil aviation authority:

The encouragement of structural changes on the lines now envisaged calls for more purposive regulation of the industry than the present legislation and licensing system permit. The Government accept that the task should be carried out by a Civil Aviation Authority charged by Statute to act in accordance with the objectives and policies laid down in the Government’s formal policy statements.

[...]

The Government believe that the economic regulation of the industry should continue to be carried out by an expert body that is not subject to detailed supervision by Ministers in its day to day decisions and which, therefore, should lie outside the normal framework of a Government department. As the Report points out, a separate body can speak authoritatively both to and for the industry. Within the discretion allowed it by the Government’s formal policy statement and directives, detailed decisions can be taken with full knowledge and understanding and with undivided attention.⁶

The White Paper was followed by the new Conservative Government’s *Civil Aviation Bill* in the 1970-71 session of Parliament. In his speech at Second Reading, the Minister for Trade, Michael Noble, introduced the concept of the [Civil Aviation Authority \(CAA\)](#) as follows:

¹ *British Air Transport in the Seventies: Report of the Committee of Inquiry into Civil Air Transport*, Cmnd. 4018, May 1969, para 1

² *ibid.*, para 985

³ *ibid.*, paras 988-1003

⁴ *ibid.*, paras 1004-1008

⁵ *ibid.*, para 1085

⁶ Board of Trade, *Civil Aviation Policy*, Cmnd. 4213, November 1969, paras 15 and 89

In the civil aviation context the Civil Aviation Authority has two main aspects. It reflects the fact that airlines are increasingly operating in a single environment. There are, indeed, very close links between the economics and the financial health of the airlines and the safety of their operations, and between operational safety, airworthiness, air traffic control, and navigational services. It does not, I think, make sense to try to regulate all these different things in different compartments and this is why the Civil Aviation Authority is, I believe, very much needed at this moment.

It is, of course, a constitutional innovation. The key point perhaps is that we are in this Bill hiving off a regulatory function. Ministers remain responsible to Parliament for policy, but detailed decision rests with the Authority.⁷

The *Civil Aviation Act 1971* received Royal Assent on 5 August 1971 and the CAA was established as a public corporation on 1 April 1972.

The 1971 Act was repealed by the *Civil Aviation Act 1982* and further duties as regards economic regulation of airports were given to the CAA by the *Airports Act 1986*. Broadly, the made the CAA responsible for four main areas of regulation – economic, safety, airspace policy and consumer protection. Economic regulation would apply in general to airports at which annual turnover exceeded £1 million in two of the previous three financial years. The CAA's key economic functions were essentially limited to:

setting maximum limits on the airport charges levied by airports that have been designated by the Secretary of State, broadly every five years;

referring public interest matters in respect of designated airports to the Competition Commission, and setting conditions to remedy public interest findings made by the Commission, again every five years; and

investigating unreasonable discrimination—or other forms of anti-competitive conduct—by airports.⁸

Of these, the most commonly known and commented upon was the quinquennial reference to the Competition Commission as regards airport charges at designated airports (i.e. London Heathrow, Gatwick, Stansted, and Manchester). This required the CAA to impose conditions on the operators of designated airports to regulate the maximum they could levy in charges over a five year period (or quinquennium). The quinquennial review was introduced following the privatisation of BAA plc in 1987. The last quinquennial review under the old legislation was in 2008-09.⁹

In March 2009 a European Directive on airport charges was agreed ([2009/12/EC](#)). The Directive set common principles for the levying of airport charges at Community airports. It applies to any airport located in the EU and open to commercial traffic whose annual traffic is over five million passenger movements and to the airport with the highest passenger movement in each Member State. The Directive was brought into force in the UK on 10

⁷ [HC Deb 29 March 1971, c1173](#)

⁸ HL Regulators Committee, *UK Economic Regulators* (first report of session 2006-07), HL 189, 13 November 2007, [memorandum by the CAA](#)

⁹ CAA, *Economic Regulation of Heathrow and Gatwick Airports 2008-2013: CAA decision*, 11 March 2008; and *Economic Regulation of Stansted Airport 2009-2014: CAA Decision*, 13 March 2009 [Manchester Airport was de-designated for regulatory purposes from 1 April 2009 under [SI 2008/2702](#)]

November 2011; it applies to: Heathrow; Gatwick; Stansted; Manchester; Luton; Birmingham; Edinburgh; Glasgow; and Bristol.¹⁰

2 The new regulatory regime from 2012

The *Civil Aviation Act 2012* set out a new system of airport regulation. This in turn meant that the CAA's economic regulation powers for the non-designated airports in England, Scotland and Wales under part 4 of the 1986 Act (see above) and for the non-designated airports under the *Airports (Northern Ireland) Order 1994 (SI 1994/426)* ceased from 6 April 2013. Its powers under the 1986 Act for the designated airports of Heathrow, Gatwick and Stansted ceased from 1 April 2014.

Starting in May 2011, the CAA undertook market power tests of Heathrow, Gatwick and Stansted airports. This test consists of three parts:

A – that the airport operator has, or is likely to acquire, substantial market power in a market, either alone or taken with other such persons as the CAA considers appropriate;

B – that competition law does not provide sufficient protection against the risk that the airport operator may engage in conduct that results in an abuse of the substantial market power; and

C – that, for users of air transport services, the benefits of regulating the airport operator by means of a licence are likely to outweigh the adverse effects.¹¹

In January 2014, the CAA published its findings that Heathrow and Gatwick met the market power tests. The CAA found that Stansted did not meet the tests for services to passenger airlines at the airport. In March 2014, the CAA found that Stansted did not meet the tests for services to cargo airlines at the airport.¹² This meant that unlike under the previous system, Stansted would not be subject to economic regulation from 2014 onwards.

The sixth quinquennial review (Q6) of regulated airports, the first under the new system, started in June 2011 and was completed in February 2014. Q6 started on 1 April 2014 for both Heathrow and Gatwick and will run until 31 December 2018 for Heathrow and until 31 March 2021 for Gatwick.¹³

Announcing its final decisions on economic regulation at Heathrow, Gatwick and Stansted after April 2014, the CAA stated that passengers would benefit from 'lower prices and high service standards'. At Heathrow prices would fall in real terms by 1.5 per cent a year between 2014 and 2019 (RPI-1.5%), while Gatwick would be allowed to proceed without a price cap, but it would have a licence, allowing the CAA to step in to protect users, for instance if there are reductions in service quality that are against the passenger interest.¹⁴

There was a mixed response to the announcement. Heathrow was critical, stating:

¹⁰ *Airport Charges Regulations 2011 (SI 2011/2491)*

¹¹ CAA, *Airport market power assessments* [accessed 19 June 2014]

¹² for full details and links to the individual assessments, see *ibid.*

¹³ CAA, *Quinquennial Reviews of Designated Airports* [accessed 19 June 2014]

¹⁴ CAA press notice, "Good news for air passengers as prices set to fall at UK's largest airports", 10 January 2014; includes links to the detailed settlements for both airports and Stansted

The CAA's final decision includes aggressive operational, commercial and passenger forecasts. It requires Heathrow to reduce operational expenditure by more than £600 million, stretches commercial revenue targets by in excess of £100 million, which includes revenues from retail and car park charges, and assumes significant passenger volume growth over Q6. The settlement leaves little spare resource available to manage the consequences of potential disruption at Heathrow.¹⁵

Gatwick welcomed the CAA's recognition that its Contracts and Commitments framework is "the best way forward for regulation and we are pleased that the CAA has recognised the significant progress the airport has made under new ownership". However, it was:

... very disappointed with key elements of the CAA's final decision, including the over-optimistic long term passenger forecasts, the reduction in the cost of capital, and the more onerous monitoring regime.¹⁶

Stansted welcomed the decision not to enforce a licence on the airport.¹⁷

3 Process of reform, 2006-2012

There had been calls for reform of the economic regulation of airports for many years, some of them from the CAA itself. For example, in its evidence to the Lords Regulators Committee in 2007 the CAA indicated that in its view it should have responsibility for deciding whether airports are designated for price control purposes in line with other sectoral regulation; that there might be an argument for the authority's concurrent powers to apply competition law to be extended to airports; and that the 'public interest' should be better defined.¹⁸ Previously, in November 2006, the Transport Select Committee published a report on the CAA and recommended that the Government review the whole process of price control, the continuing need for the designation of airports subject to economic regulation and make CAA airport review decisions subject to the standard regulatory model.¹⁹

3.1 Early reviews, 2007-09

Subsequently, between 2007 and 2009 there were broadly three strands of work on airport regulation: the Pilling strategic review of the CAA (October 2007-June 2008); the Department for Transport's review of, and subsequent consultation on, airport regulation, supplemented by the work of the independent panel chaired by Prof. Martin Cave (April 2008-December 2009); and the Competition Commission's investigation into BAA (March 2007-March 2009).

The **Pilling strategic review of the CAA** was published in July 2008. The Pilling Review made over 40 recommendations, mostly to do with the internal organisation and working of the CAA, but he did make two recommendations on economic regulation: that the CAA's duty towards users should be amended to give greater weight to passengers or consumers and that the Department propose amending the existing legislation to remove the automatic statutory reference to the Competition Commission in the setting of airport price caps.²⁰ In a

¹⁵ HAHL press notice, "[Heathrow's response to CAA's Q6 price control decision](#)", 10 January 2014

¹⁶ Gatwick Airport press notice, "[London Gatwick responds to the Civil Aviation Authority's final decision on economic regulation from April 2014](#)", 10 January 2014

¹⁷ Stansted Airport press notice, "[M.A.G responds to CAA economic regulation announcement](#)", 19 January 2014

¹⁸ op cit., *UK Economic Regulators*, memorandum by the CAA

¹⁹ Transport Committee, *The work of the Civil Aviation Authority* (thirteenth report of session 2005-06), HC 809, 8 November 2006, paras 31-36

²⁰ DfT, *Report of the strategic review of the CAA*, June 2008, recommendations 29 and 30

November 2008 statement to the House the then Secretary of State, Geoff Hoon, broadly accepted all Sir Joseph's recommendations and stated that they would be taken forward.²¹

In April 2008 the then Secretary of State for Transport, Ruth Kelly, announced what became known as the **Cave Review of the economic regulation of UK airports**.²² The terms of reference stated that the scope of the review would cover the objectives of effective economic regulation of airports; weaknesses with the current system and lessons from other systems. The review was undertaken by the Department, with the advice of a panel of experts, chaired by Professor Martin Cave of Warwick University. The DfT published an 'emerging thinking' document in November 2008,²³ followed by a consultation document in March 2009.

The final report of the Cave Review, submitted to the Secretary of State in January 2009, had concluded that the airport regulator's primary duty should be the promotion of the interests of passengers and freight users. The report also proposed a tiered approach to airport licensing involving a licence-based regime in which airports with significant market power (i.e. Gatwick, Heathrow and Stansted) would be subject to price control, in a manner chosen and implemented (subject to appeal) by the CAA. A second group of about ten airports, subject like the first to the EU Airport Charges Directive, would have obligations under that directive, including that of consulting users on airport charges. A further dozen or so airports, with more than a million passengers per annum, would remain subject to the conditions which already applied to them.²⁴

Geoff Hoon said that the proposals in the consultation document, published on the back of the Cave Review, were designed to 'put the passenger at the heart of the regulatory regime'. They were to: give the CAA a primary duty towards the passenger; put the consumer representation for air passengers on a statutory footing for the first time; introduce a licence-based scheme of regulation; give the CAA an environmental duty; and require the 13 airports with more than 5 million passengers per annum to produce an annual report on the environmental impact of their operations, and their mitigation measures.²⁵

Finally, there was the **Competition Commission investigation into BAA**, which at the time owned all three major London airports (Heathrow, Gatwick and Stansted). In April 2008 the Commission published a report on its 'emerging thinking' and in December 2008 it reported on its 'provisional findings'. The final report was published on 19 March 2009 and though most of the focus was understandably on the implications for BAA, the Commission also made recommendations about the regulation of airports by the CAA. The Commission was concerned about the absence of statutory duties and economic licence provisions on BAA; the limited scope for the regulator to act between quinquennial reviews; and the narrow focus of the CAA's statutory duties in economic regulation.²⁶ The Commission also indicated its

²¹ HC Deb 26 November 2008, cc106-107WS

²² HC Deb 22 April 2008, cc100-102WS

²³ DfT, *Emerging thinking of the independent panel on airport regulation*, 27 November 2008

²⁴ DfT, *Report of the independent panel on airport regulation*, 27 January 2009, summary

²⁵ HC Deb 9 March 2009, cc4-6WS; and DfT, *Reforming the framework for the economic regulation of airports*, 9 March 2010

²⁶ CC, *BAA airports market investigation: A report on the supply of airport services by BAA in the UK*, 19 March 2009, p270 [the CC is now part of the Competition and Markets Authority]

support for the tiered approach to airport licensing, as set out in the DfT's consultation document (see above).²⁷

The Commission went on to make detailed recommendations on how three aspects of this licensing regime should be shaped to remedy the adverse effects between airlines of the then system of regulation. On the regulator's principal objectives and duties it largely agreed with the Government's approach and recommended that the regulator's primary objective should focus on the consumer interests; it should be specifically required to take account of airline views; and it should have information-gathering powers, and powers to impose penalties.²⁸

3.2 Labour Government's proposals for reform, 2009-10

In December 2009 the Labour Government published its decision document on reforming the framework for the economic regulation of airports. This was accompanied by a further consultation on the CAA's broader regulatory role.²⁹ The decision document set out a framework for the CAA's future financial resilience, enhancing its accountability and changing passenger representation. However, the main changes were to do with reforming the CAA's statutory duties as economic regulator, in particular introducing a new licensing regime and aligning airport services with passenger need. The Government proposed a new 'single primary duty' of the CAA to: "... promote the interests of existing and future end consumers of passenger and freight services at airports in Great Britain, wherever appropriate by promoting effective competition". And further supplementary duties:

... to have regard to the airport operator's legal obligations to comply with applicable environmental and planning law;"

"to secure, so far as it is economical to meet them, that all reasonable demands for airport services are met efficiently;"

"to ensure that licence holders are able to finance the activities which are subject to the relevant licence obligations;"

"to have regard to guidance issued by the Secretary of State, as well as any National Policy Statement on airports;" and

"to have regard to the principles of Better Regulation and to consult with stakeholders, including airlines".³⁰

There would also be a new licensing regime, bringing airports into line with many other regulated sectors. This would involve a two tier licensing structure:

Airports in Tier 1 will be those with substantial market power where regulatory intervention is warranted, while those in Tier 2 will be all other airports meeting the 5 million passenger a year threshold in the Airport Charges Directive (ACD). Currently, apart from provisions necessary to ensure that the licence is effective, such as a

²⁷ *ibid.*, p272

²⁸ *ibid.*, pp276-277

²⁹ DfT, *Regulating Air Transport: Consultation on Proposals to Update the Regulatory Framework for Aviation*, December 2009

³⁰ DfT, *Reforming the Framework for the Economic Regulation of Airports Decision Document*, December 2009, paras 1.11-1.12

revocation condition, the DfT is anticipating that the Tier 2 licences will only include provisions directly related to the ACD.³¹

The CAA would also have new sanction and enforcement powers for breach of licences; the power to impose financial penalties for the breach of licence conditions; and concurrent competition law enforcement powers for services provided by airport operators.

In a statement, the CAA broadly welcomed the changes:

The Government has decided to give the CAA a primary duty for its economic regulation role to promote the interests of existing and future consumers, alongside a new licensing regime for airports. These changes will provide a framework for a more flexible, licence-based approach to economic regulation, enabling us to put the interests of passengers at the centre of our activity, and ensuring that our regulation is transparent and proportionate. These changes bring the CAA in line with other economic regulators and provide clarity for airlines and airport operators. Operating in accordance with this new duty will mean we need to work closely with airlines and other stakeholders to better understand different perceptions of the passenger interest, alongside maintaining close working relationships with all stakeholders.³²

Nothing further happened before the 2010 General Election.

3.3 Coalition Government's proposals for reform, 2010-12

In its first Queen's Speech after taking power in May 2010, the Conservative-Liberal Democrat Coalition Government indicated an intention to introduce a Bill to "reform the economic regulation of airports to benefit passengers".³³ Preliminary information indicated that it would "replace the existing system for setting price caps at airports which are subject to economic regulation with a more flexible framework focused on the outcomes that matter to passengers".³⁴

On 21 July the then Secretary of State for Transport, Philip Hammond, announced how the Coalition Government intended to proceed on the reform of airport regulation. This was in many ways a continuation of the review and policy process begun under Labour, and the conclusions of the new Government were similar to those announced in December 2009. Mr Hammond stated that the Government would:

- introduce a new set of duties for the CAA's economic regulation of airports to put the interests of passengers 'unambiguously at the heart' of the regime;
- give the CAA a primary duty to promote the interests of existing and future passengers;
- introduce a new licensing regime to be applied only to airports with substantial market power and where such regulation adds real value;
- reform the framework for airport economic regulation to drive passenger-focused investment in better facilities such as baggage handling equipment or terminal

³¹ *ibid.*, para 1.14

³² CAA press notice, "[CAA response to the DfT's consultation on proposals to update the regulatory framework for aviation](#)", 10 December 2009

³³ [HC Deb 25 May 2010, c31](#)

³⁴ Number 10 press notice, "[Queen's Speech – Airport Economic Regulation Bill](#)", 25 May 2010

improvements while removing unnecessary bureaucracy and political involvement from the regulatory process;

- introduce a supplementary financing duty and minimum credit worthiness requirements as well as ring-fencing conditions where there is a net benefit in introducing such measures;
- require the preparation of plans for continuity of service should an airport operator get into financial difficulties;
- provide the CAA with the option, where appropriate, to respond to anti-competitive behaviour using competition law powers rather than by applying its regulatory tools and grant the CAA concurrent powers with the Office of Fair Trading;
- introduce civil sanctions, including financial penalties, for the CAA to enforce licence conditions; and
- introduce a system for merit-based appeals, to a body with relevant expertise, against certain decisions taken by the regulator.³⁵

At the same time, the Government published more detailed information on its decisions regarding the grant to the CAA of concurrent competition powers and promoting financial resilience for major airports.³⁶

In November 2011 the Department for Transport published a draft *Civil Aviation Bill*, this contained the Government's proposals for regulatory reform of airports and further reforms of the CAA, as set out above.³⁷ The Transport Select Committee conducted pre-legislative scrutiny of the draft Bill and published a report in January 2012. This concluded that:

Given the greater degree of competition that now exists between airports in the south east of England and the difficult business conditions facing many regional airports, we are clear that the CAA should undertake its economic regulatory duties with a relatively light touch. We believe this would be consistent with the Government's better regulation principles and with what the Government would expect of the CAA.³⁸

The Committee also made some more detailed recommendations on the proposed new regulatory regime:

- greater clarity in the wording of the Bill's definition of users of air transport services and more specificity in the CAA guidance regarding the relative weight that should be put on current versus future air transport users' interests;

³⁵ HC Deb 21 July 2010, cc20-21WS

³⁶ DfT, *Granting CAA Concurrent Competition Powers: Analysis of Consultation Responses and Government's Decision*, July 2010; and: DfT, *Promoting Financial Resilience for Major Airports: Analysis of Consultation Responses and Government's Decision*, July 2010

³⁷ DfT, *Draft Civil Aviation Bill: An effective regulatory framework for UK aviation, Volume 1: Policy Paper*, Cm 8234-I, November 2011, paras 2.9-2.11; other documentation, including the draft bill and explanatory notes, impact assessment and summary of responses to consultation are available on the Gov.uk website [accessed 19 June 2014]

³⁸ Transport Committee, *Draft Civil Aviation Bill: Pre-legislative Scrutiny* (thirteenth report of session 2010-12), HC 1694, 12 January 2012, para 84

- that the special position of airlines be recognised by way of a secondary duty in the Bill;
- that the CAA clarify how it intends to ascertain the interests of transport users and how the proposed Aviation Consumer Advocacy Panel would relate to the regulatory process;
- that the CAA take account of issues surrounding passenger welfare, particularly providing support to stranded passengers during periods of disruption, when setting licence conditions;
- that the bill be amended to require the CAA to provide impact assessments for the licence conditions imposed on airports;
- that airport licences should be structured so that they address key areas of passenger dissatisfaction; and
- that the Government ensures that the Competition Commission and other relevant appeals bodies have the power to strike out frivolous or vexatious appeals.³⁹

The Bill was published on 19 January 2012 and received Royal Assent on 19 December of the same year.⁴⁰

³⁹ *ibid.*, conclusions and recommendations

⁴⁰ for full details about the Bill and information on its passage through Parliament, see: HC Library research papers RP 12/7, [Civil Aviation Bill](#), 24 January 2002; and RP 12/19, [Civil Aviation Bill: Committee Stage Report](#), 20 April 2012