

NON-CONFIDENTIAL VERSION**easyJet response to CAP2554 – Economic Regulation of Gatwick Airport Limited: Consultation on proposal to extend the current commitments****1 INTRODUCTION AND SUMMARY**

1.1 easyJet Airline Company Limited (“**easyJet**”) welcomes the opportunity to comment on the Civil Aviation Authority (“**CAA**”) consultation paper CAP2554 on the economic regulation of Gatwick Airport Limited (“**GAL**”) and the proposal to extend the set of commitments which are currently included as conditions in GAL’s economic licence (the “**Consultation Paper**”).

1.2 For the reasons outlined in this response, easyJet would request that the CAA undertakes a detailed assessment of whether GAL’s proposals, especially in relation to the revised price cap, are fair, reasonable, and in the best interests of passengers.

Background to the Consultation

1.3 easyJet is the United Kingdom’s largest airline by passenger numbers¹ and the largest airline operator at Gatwick Airport (the “**Airport**”) carrying currently 46% of GAL’s traffic.² As such, easyJet and its passengers bear the greatest impact of GAL’s proposals of any other airline operating at the Airport.

1.4 In January 2014, the CAA concluded that GAL had significant market power (“**SMP**”) with respect to the provision of airport operation services to passenger airlines at the Airport.³ The CAA noted in its market power determination that GAL could abuse its SMP “*through excessive pricing, inefficiency, inferior service quality or investment*”.⁴ GAL therefore holds a position of SMP and the applicable economic regulation is of critical importance to ensuring that the interests of Airport passengers are protected.

1.5 As noted in the Consultation Paper, since 1 April 2014 GAL has been regulated primarily by a set of “commitments”, included as conditions of GAL’s economic licence (the “**Licence**”). The original commitments imposed in 2014 were set to expire on 31 March 2021. However, following a period of consultation, and taking into account the impact of the Covid-19 pandemic, the CAA decided to modify GAL’s Licence, including the commitments, in order to implement GAL’s proposed commitments for the period 1 April 2021 until 31 March 2025 (the “**Current Commitments**”).

1.6 The current proposal from GAL is to extend the Current Commitments from 1 April 2025 to 31 March 2029 with a limited selection of modifications in relation to: (i) a revised price cap to CPI-1% from 1 April 2025 – 31 March 2027 and CPI + 0% from 1 April 2027 – 31 March 2029; (ii) a maintenance of the investment commitment of £120m per year over the ten years from 2019/20

¹ [UK airline passenger numbers 2022 | Statista.](#)

² Based on OAG data for the period of Winter 2022 to Summer 2023.

³ CAP1134: Market Power Determination in relation to Gatwick Airport – Statement of Reasons. See, for example, paragraph 5.27.

⁴ Ibid. Paragraph 6.22.

NON-CONFIDENTIAL VERSION

to 2028/29; and (iii) an intention to introduce a Core Service Standard (“CSS”) metric on Air Traffic Control (“ATC”) and Passengers with Restricted Mobility (“PRM”) performance (“GAL’s Proposals”).

- 1.7 Since the implementation of the commitments framework in 2014, the CAA has not conducted a substantive assessment of whether it remains in the best of interests of passengers. Although the CAA has conducted limited reviews of the framework in the 9 years since it has been in place, the CAA has also been clear that it has intended to conduct a more detailed review⁵:
- (a) In December 2016, the CAA published its light-touch mid-term review of the commitments framework, focussing on GAL’s service quality and airport resilience (including on-time performance), GAL’s investment performance and GAL’s relationship with airlines and other stakeholders. The CAA did not propose any specific changes to the commitments framework, but it noted the concerns on the progress of airfield investment projects and some aspects of GAL’s relationships with airlines.
 - (b) In June 2018, the CAA undertook a light-touch review in relation to the process and timetable for replacing the commitments, and invited views on whether the commitments protected consumers’ interests (such as quality of service, on-time performance and value for money)⁶. The CAA indicated that it would carry out its own review and would need to be content with the proposal for modifying GAL’s licence by the end of 2020. However, the CAA did not conduct this review.
 - (c) In October 2020 the CAA consulted on GAL’s proposed modifications and extension to the Licence, but did not conduct a wider assessment on the general framework. The CAA concluded that GAL’s proposal should be accepted “in the light of the impact of Covid-19”, and in February 2021 the CAA invited stakeholders to comment on the precise modifications to the Licence (which the CAA later approved in May 2021).

GAL’s Proposals require a detailed assessment

- 1.8 The success of a lighter touch regulatory framework in acting as an effective control on the exercise of SMP can only be judged by its outcomes.
- 1.9 GAL is the only airport in the United Kingdom or Europe, designated as holding SMP, which is subject to what the CAA recognises as a “lighter touch regulatory framework”.⁷ Yet in terms of service quality, GAL’s current performance is unfortunately below the performance of other large airports in Europe.
- 1.10 There is insufficient evidence available for easyJet to assess GAL’s Proposals:
- (a) GAL cites continued economic uncertainty as justifying a continuation of the Current Commitments for a further four years. In light of this continuing uncertainty, surely it is

⁵ Bullet Point 4, Paragraph 3 of the Executive Summary of CAP 1152: Economic regulation at Gatwick from April 2014: Notice granting the licence.

⁶ Paragraph 3.19 of CAP1684: Future economic regulation of Gatwick Airport Limited: initial consultation.

⁷ Paragraph 1.6 of the Consultation Paper.

NON-CONFIDENTIAL VERSION

essential that GAL's Proposals are properly assessed to ensure that passenger outcomes will be maximised.

- (b) GAL also cites the unknown impact of the Northern Runway extension. However, if it proceeds, the extension will not be operational until 2030 at the earliest. GAL's Proposals do not clarify the extent to which (if at all) airlines will bear any costs associated with the development of the Northern Runway extension before it is operational.

There are outstanding questions in relation to GAL's Proposals

1.11 As the operator of an airport with SMP, it is essential that the prices charged by GAL are fair and reasonable and do not allow for excess profits. In its mid-term review, the CAA could not rule out the prospect that GAL's proposed price cap could lead to excess profits. easyJet does not have the information that would allow it to fully assess GAL's Proposals to ensure that they are in the best interests of passengers. easyJet has only been able to undertake an assessment based on publicly available data, but this assessment suggests that:

- (a) GAL may be operating more profitably than comparator airports (i.e. other airports with SMP) under a dual till regime; and
- (b) An appropriate price cap of CPI for an airport operator with market power, similar in size and costs to GAL could potentially be as low as -40% (significantly lower than GAL's proposed CPI-1%/CPI+0)

1.12 Given the large disparity between GAL's proposed price cap and the CPI up to -40% calculated by easyJet, there is a need for further analysis to be conducted by the CAA.

1.13 The CAA has previously indicated that it intends to focus its analysis of GAL's Proposals on those areas of concern identified by airline operators⁸. In this regard, we would request that the CAA engages in a robust review, to satisfy itself that GAL's Proposals, particularly in relation to the price cap, are in the best interest of passengers. A reasonable and appropriate baseline should be applicable across all airlines via the regulation - this is not something that airlines are able to do independently.

Conclusion and structure of this response

1.14 In light of the above, easyJet would request the CAA to fully assess GAL's Proposals, particularly in relation to the price cap, in order to conclude that they are fair, reasonable and in the best interest of passengers.

1.15 easyJet's consultation response is structured as follows:

- Section 2: sets out easyJet's position on the general principles of GAL's Proposals;

⁸ Meeting between the CAA and ACC, 15 June 2023.

NON-CONFIDENTIAL VERSION

- Section 3: sets out easyJet's position on the conditions of GAL's Proposals including the proposed revision to the price cap;
- Section 4: outlines easyJet's conclusions on GAL's Proposals.

1.16 easyJet is grateful for the opportunity to provide its feedback and remains committed to supporting the CAA with this process.

2 GENERAL PRINCIPLES OF GAL'S PROPOSALS

2.1 Notwithstanding that easyJet has previously raised a number of concerns with the commitments regulatory framework,⁹ easyJet also acknowledges that the framework has fostered some success in its initial period of 2014 to 2019. GAL, in CAP2554A, places particular emphasis on those successes in favour of its proposals.¹⁰

2.2 However, the relative and historic successes of the commitments framework alone do not support a conclusion that GAL's Proposals will be in the best interests of passengers. It does not seem appropriate to extend a framework with no substantial review by the CAA until **2029**.

2.3 An assessment of GAL's Proposals by the CAA is particularly important, as GAL itself is proposing a change in price from RPI+0, to CPI-1 / +0.

2.4 As explained further in section 3 below, there have been recent issues with GAL's service quality and it cannot be ruled out that GAL's current charges (and thus any future charges permitted pursuant to the commitments) allow for excess profits.

2.5 easyJet understands that GAL provides a yearly shadow RAB to the CAA so that the CAA can quickly step in to review aspects of GAL's prices. easyJet acknowledges that the shadow RAB is confidential to GAL, although, the data is available to the CAA and could be used as a basis for the CAA's assessment.

3 THE SPECIFIC CONDITIONS OF GAL'S PROPOSALS

3.1 Price cap

GAL's proposals

3.1.1 GAL's central proposal is to extend the Commitments from 1 April 2025 to 31 March 2029 with a revised price cap of CPI-1% from 1 April 2025 – 31 March 2027 and CPI+0% from 1 April 2027 – 31 March 2029. However, GAL stipulate a proviso that the cap should not fall in nominal terms during the first two years of the extension, resulting in GAL taking the benefit, but not the burden, of

⁹ For example, significant cost increases in PRM services and service targets on security queues as outlined in easyJet's response to the CAA's October 2020 consultation (**CAP1973**): <https://www.caa.co.uk/media/fqbpzkqe/easyjet-cap1973.pdf>.

¹⁰ For example, GAL note that its charges have remained below GAL's pricing commitment over the period of 2014 to 2021: CAP2554A, Page 13.

NON-CONFIDENTIAL VERSION

inflationary changes during this period. GAL's initial proposal was a price cap of RPI+0% for all four years.

3.1.2 easyJet welcomes GAL's movement from the RPI to CPI benchmark, which is a more appropriate measure of inflation. However, easyJet has not been provided with the information to allow it to assess whether the proposal is fair and reasonable. easyJet's conservative assessment based on publicly available data suggests that GAL's proposed price could potentially be up to 40% too high and may allow for excessive profits. Accordingly, easyJet requests the CAA to conduct a detailed and objective analysis of GAL's Proposals to satisfy itself that the price cap is in the best interest of passengers.

3.1.3 Specifically in relation to GAL's price cap, easyJet is concerned that GAL:

- (a) may not be incentivised to innovate and generate efficiencies;
- (b) may not have used the right comparators benchmarking itself against other airports (e.g. airports with no SMP or with Dual Till¹¹) and failing to consider different operating costs/models; and
- (c) may not have adopted the appropriate methodology when looking at profitability and maximum efficient yield. It is unclear to easyJet how GAL could be certain that the proposed price cap is in the best interest of passengers or is financially sustainable (i.e. cost coverage).

easyJet is unable to robustly analyse the proposals on the data provided

3.1.4 GAL has not provided easyJet with the specific information required to conduct a detailed and thorough analysis of GAL's proposal for the price cap.

3.1.5 For example, [REDACTED].

3.1.6 GAL stated that [REDACTED]. easyJet recognises that GAL is not subject to RAB based price review, yet it is required to produce a yearly shadow RAB to the CAA.

3.1.7 In light of this, easyJet cannot meaningfully engage with GAL's Proposals without assistance from the CAA. Given its access to the relevant data and its position as the sectoral economic regulator, only the CAA can conduct this analysis.

Level of profits under the Current Commitments

3.1.8 As part of the consultation process during the previous extension of the commitments framework in 2020, the CAA stated that it "cannot rule out scenarios under which the cap might allow GAL to earn relatively high profits towards the end of the next period, there are other scenarios under which GAL's profits might remain at a relatively low level throughout the period" (i.e. 2021 – 2025).

¹¹ See Figure 13 of [CAP2554A](#).

NON-CONFIDENTIAL VERSION

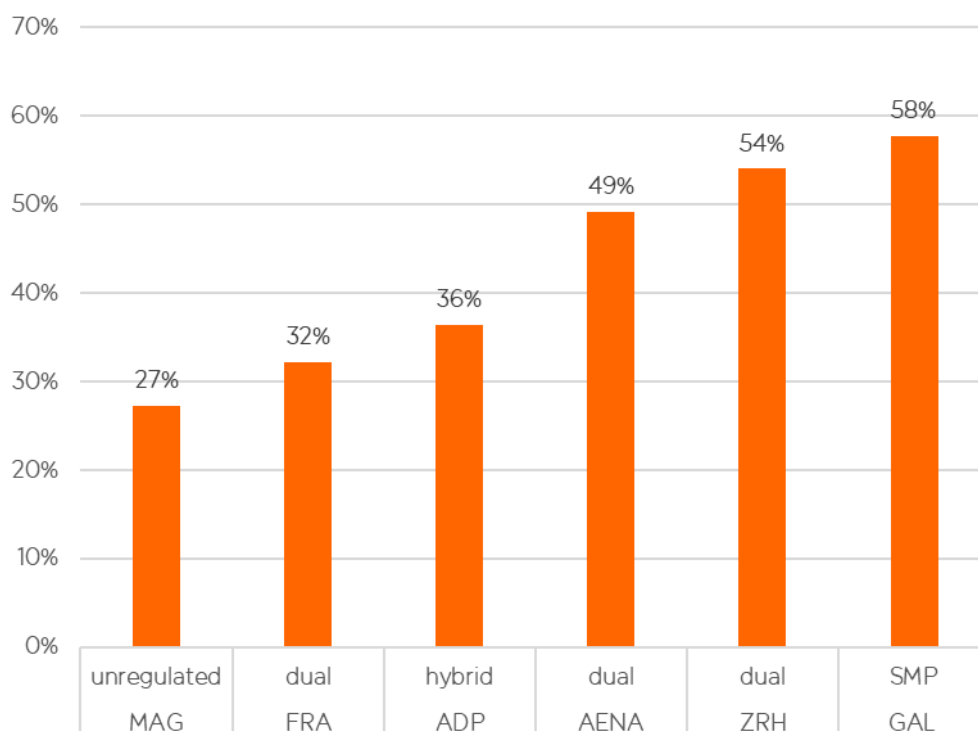
- 3.1.9 Publicly available data would appear to support the CAA's concerns regarding the potential for excess profits. To illustrate, GAL's net profit in the calendar year 2022 was £196.5 million and GAL's operating profit for the same period was £251.6 million¹². The CAA in its letter of 23 December 2020¹³ to the Airport Consultative Committee ("**ACC**") contained the CAA's projections of GAL's regulatory operating profit. The operating profit achieved by GAL in 2022 materially exceeds the CAA's projections of regulatory operating profit on the "*optimistic traffic case*" by c.£100m.
- 3.1.10 Furthermore, evidence suggests that GAL's profit margins in 2022 were greater in comparison to similarly situated airport operators.
- 3.1.11 For example, based on public data, easyJet has analysed the EBITDA margin of similarly situated European and UK airports at [Figure 1](#) below, finding that GAL at 58% in 2022 had the highest EBITDA margin in the benchmark. This analysis suggests that GAL's profit margins in 2022 were greater than its peers.¹⁴

Figure 1: EBITDA % Comparison

¹² Page 41 of GAL's annual report and the consolidated and parent company financial statements for the year ended 31 December 2022: <https://www.gatwickairport.com/globalassets/company/investor/2022/ivy-holdco-limited-consolidated-financial-statements-31-december-2022.pdf> (Accessed 20 July 2022)

¹³ [CAP 2103L](#).

¹⁴ easyJet proposes to use EBITDA instead of ROCE as an indication of GAL's profitability. We believe using EBITDA margin is more relevant than the ROCE because ROCE is often influenced by investment cycles, depreciation choices and tax rates, while EBITDA excludes specifically those elements. EBITDA primarily focuses on a company's operating performance and provides a clearer picture of the profitability of the core operations of a business. By excluding non-operating factors, EBITDA allows for a more direct comparison between different companies or industries. ROCE, on the other hand, considers the capital employed in a business, including both equity and debt. This can make it challenging to compare companies with significantly different capital structures.

NON-CONFIDENTIAL VERSION

3.1.12 easyJet notes that GAL's net profit in 2022 was 28.9% higher than the net profit achieved in 2019. Furthermore, the profit per passenger achieved by GAL in 2022 materially exceeds the profit per passenger of Fraport (+300%) and AENA (+160%). Additionally, GAL's ROCE of 7% in 2022 was higher than Fraport, Zurich, ADP, and MAG in the same period (4%)¹⁵.

3.1.13 We recognise that the proposed Northern Runway extension will have an impact on GAL's costs of doing business, as well as its revenues. However, if it proceeds, the extension will not be operational until 2030 at the earliest and it could not become part of its regulated asset based until after it is operational. At this point, the runway will have an impact only on take-off and landing charges which represent on average only 9% of airport costs at GAL. It will also increase GAL's cost of capital remuneration, depreciation and interests. However, none of this prevents an assessment by the CAA of GAL's prices that airlines will be paying from 2025.

Assessment of GAL's proposed price cap

3.1.14 easyJet has conducted calculations, from publicly available data, of GAL's proposed price cap. The calculations indicate that GAL's proposed price cap could potentially be:

- (a) up to **40%** higher than the revenue required for a regulated airport with a single till; and

¹⁵ Data collated from public Annual Reports.

NON-CONFIDENTIAL VERSION

(b) up to **30%** higher than GAL's reported average aviation revenue for 2022.¹⁶

3.1.15 Allowing for the inclusion of the anticipated £2bn investment for the Northern Runway, easyJet has estimated a price cap of CPI-13%.

3.1.16 Given the disparity between GAL's proposed price cap and the figure of CPI-40% (or CPI-30%)¹⁷ calculated by easyJet, there is evidently a need for further analysis.

3.1.17 CAP2554 does not explain whether the CAA has conducted its own assessment of the proposed price cap, although our understanding is that the CAA intends to concentrate its analysis in areas identified by stakeholders.

easyJet's request for further analysis

3.1.18 It is in the best interests of passengers that GAL's proposed price cap be fully examined to rule out the risk of excessive profits and easyJet would request the CAA to conduct an objective analysis to decide if the proposals can be accepted.

3.1.19 In conducting this analysis, easyJet considers that the most appropriate framework would be a bottom up, single till RAB model. At least, a detailed assessment of profitability (such as calculations of the EBITDA¹⁸) is essential, using as a comparator market operators of similar size and scope designated as having SMP.

3.2 Service Standards

3.2.1 easyJet welcomes GAL's proposals to introduce two additional CSS; a metric on air traffic control performance and a financial penalty on PRM service provision.¹⁹ easyJet is engaging with GAL's ongoing CSS consultation. However, easyJet has concerns about the recent decline in services at the Airport. In particular, easyJet's experience is that the CSS act as a baseline service level for GAL rather than an aspirational target. Even if GAL in certain cases meets the CSS, its quality of service can still fall short of reasonable expectations. For example:

(a) GAL has recognised that in the summer of 2022 there were ATC failings which resulted in a large number of flight cancellations. Unfortunately, the situation has not improved this Summer. With a view to trying to resolve these issues, easyJet, GAL and NATS have formed a working group and easyJet will continue to work closely and collaboratively with GAL and NATS. However, easyJet would welcome a mechanism whereby there was a clear incentive for GAL to invest in and improve customer service standards.

(b) Many of the CSS have long-moving average targets which do not reflect passenger experiences on an hourly or daily basis. While GAL may meet the CSS in relation to security and wait time by achieving the target waiting period across the year, the current wait times

¹⁶ See attached Annex A.

¹⁷ (CPI-13%) allowing for the inclusion of the anticipated £2bn investment for the Northern Runway.

¹⁹ easyJet notes that it has not received further detail on the form of these proposals.

NON-CONFIDENTIAL VERSION

experienced by passengers on a daily basis have deteriorated and are below the usual standards expected of GAL. In this regard, GAL and the ACC are currently liaising in respect of the fitness and suitability of the CSS.

- 3.2.2 As GAL's biggest airline, it is in easyJet's interest to see an improvement in GAL's service standards and performance.

Performance issues by GAL's third-party suppliers

- 3.2.3 easyJet further has concerns in the performance of GAL's third-party suppliers. This is particularly the case in relation to ATC and PRM.

- 3.2.4 easyJet has no formal recourse against third parties for their continued failings which are adversely impacting easyJet's passengers. Although GAL charges easyJet for the provision of third-party services such as PRM and ATC, GAL contracts directly with these third-party providers. easyJet has limited visibility as to whether: (i) GAL is able to meet its obligation to ensure adequacy of resources at the Airport; (ii) GAL is meeting its existing obligations under its third-party contracts; and (iii) the charges imposed on easyJet are reflective of the services which are ultimately supplied. easyJet therefore welcomes GAL's proposal to introduce a Core Service Standard metric on ATC and PRM, as these issues are critical to easyJet. GAL's decline in its levels of service evidences a need for the CAA to conduct a review of GAL's proposal, including any new metrics for ATC and PRM.

3.3 GAL's Vision

- 3.3.1 easyJet has no comments relating to the proposed Vision.

4 CONCLUSION

- 4.1 Based on the concerns illustrated in this response, easyJet would request that the CAA, as sectoral economic regulator, conduct a detailed assessment of GAL's Proposals.

- 4.2 easyJet reiterates its gratitude for the opportunity to provide its feedback to the CAA and remains committed in supporting the CAA with this process. easyJet remain at the CAA's disposal should it have any queries or further questions on the content of this submission.

Annex

Annexed Separately