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# Commentary

## Reforming Civil Aviation Regulation in the United Kingdom: The Civil Aviation Bill 2011-12

by Brian F. Havel\* and Jeremias Prassl\*\*

Following multiple rounds of pre-legislative consultation initiated under the previous Labour government, the U.K. Secretary of State for Transport presented a draft Civil Aviation Bill (the “Bill”) in November 2011. The Bill was subsequently submitted for Select Committee consultation and debate by the House of Commons in January 2012, and is now on its way to enactment within the calendar year. The Bill targets four objectives through its proposed regulatory changes: regulatory specialization, shifting of regulatory costs to the industry, prioritizing consumer interests, and greater flexibility for regulators. The present note briefly discusses each of these points in turn, before considering some of the broader implications of the new regulatory design.

By “regulatory specialization” we refer to the planned attempt to consolidate and transfer the economic and safety regulatory decision-making affecting the aviation industry to the Civil Aviation Authority (CAA).<sup>1</sup> The stated motivation behind this consolidation is the CAA’s technical expertise in aviation matters.

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<sup>1</sup> Francesc Trillas prefers the term “delegation.” See Trillas, *Independent Regulators: Theory, Evidence and Reform Proposals* 5–12 (IESE Business School, University of Navarra, Working Paper No. WP–860, 2010), available at <http://www.iese.edu/research/pdfs/DI-0860-E.pdf>.

Such a consolidation would presumably benefit the aviation industry as it would diminish the uncertainty inherent in having regulatory decisions potentially subjected to political scrutiny at the top of governmental departments.<sup>2</sup> Additionally, the more specialized regulatory focus of the agency should provide a more informed and superior regulatory decision-making process.<sup>3</sup>

The gains from technocratic expertise are unfortunately accompanied by some loss in direct accountability, given that the CAA regulators are unelected. This is perhaps best illustrated by the grant to the CAA of the ability to appoint its own executive directors and the limited external guidance proposed for CAA decisions. The lack of accountability is partially addressed by an expanded appellate process for CAA decisions. That trade-off is of a kind with similar decisions about a range of governmental functions occurring all over Europe.

The second point of emphasis reflected in the contents of the Bill is the desire to shift regulatory costs to the aviation industry. Indeed, this cost-shifting is notable because the changes concern not the normal cost effects of regulation (on airlines), but the costs of administering the regulation (as incurred by the regulators). Examples include the provision to allow the CAA to recover the costs of prosecuting noncompliance proceedings against industry actors from the actors prosecuted, as well as directives to fund the CAA's increased responsibilities through existing industry charges. The Bill makes clear its desire to shift the cost burden of regulating the aviation industry to the airlines and airports – a burden which inevitably will be passed on to the passengers and shippers – and away from general tax revenues as much as possible. While this may improve the budget outlook for other governmental agencies, and environmental opponents of the aviation industry will certainly be pleased that more of the costs of aviation are being borne by consumers of aviation, there are significant drawbacks to the approach. Regulation of the aviation industry benefits the public as a whole, not simply passengers and

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<sup>2</sup> This is one aspect of what is broadly known as the “commitment problem.” See ARMSTRONG, COWAN & VICKERS, *REGULATORY REFORM: ECONOMIC ANALYSIS AND BRITISH EXPERIENCE* 85–90 (1994).

<sup>3</sup> Information asymmetry between government and industry can contribute to inefficient regulation. Using a specialized regulator with expertise in the sector to be regulated is an attempt to correct that asymmetry and make regulation more efficient. See LAFFONT & TIROLE, *A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION* 1–35 (1993).

shippers, and it is unclear why the public should not be expected to underwrite the costs of that regulation through taxation. Additionally, unless other transportation sectors are similarly called upon to bear the costs of regulation, this shift unfairly diminishes aviation's ability to compete against those sectors. This is especially problematic when the shift of the costs of regulation to the regulated is seen against the backdrop of an industry and its customers facing escalating costs from governmental actions, for example increases to the U.K. Air Passenger Duty and the inclusion of aviation in the European Union's Emissions Trading Scheme since January 1, 2012.<sup>4</sup>

A less than effusive concern for the aviation industry also seems apparent in the Bill's clarification of the CAA's duties. The Bill requires the CAA to prioritize serving consumer interests, rendering all of its other duties subsidiary to that mission. That is arguably the proper charge for an agency tasked with economic regulation. Decisions about price caps affecting designated UK airports and other economic regulations should be primarily motivated by the creation of a competitive market. Still, the industry is dependent on the government for integral services and infrastructure, such as air traffic control and airports, so that in carrying out its newly defined duties the CAA needs to maintain some responsibility for the health of the industry it regulates. Concerns for industry health and passenger protection are more apparent factors in the decision (following amendments during the Parliamentary stages) to use the Bill to extend the coverage of the Air Travel Organisers' Licensing (known as ATOL), a protective scheme in case of tour operator insolvencies, by bringing airline and "agent for the consumer" transactions within its scope.

The final point of emphasis in the Bill is increasing regulatory flexibility. The CAA will have the ability to tailor economic regulations to specific airports, rather than using a one-size-fits-all model for all airports designated for regulation. The Bill also grants the CAA the authority to issue civil sanctions to punish noncompliance in cases not severe enough to warrant criminal proceedings. Increased flexibility is always welcome, as it diminishes the likelihood of overregulation.

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<sup>4</sup> Council Directive 08/101/EC, 2009 O.J. (L 8) 3, *available at* <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:008:0003:0003:EN:PDF>.

As regards regulatory design more broadly, the Bill is in many ways the ultimate step in a direction evident since the early beginnings of civil aviation regulation in the United Kingdom: the devolution of regulatory responsibility to specialized bodies. This development is generally to be welcomed, as evidenced by the factors discussed above. One possible danger – to the industry generally and passengers in particular – should be borne in mind, however: the potential for regulatory capture in situations where a few dominant economic actors (be they operators of multiple key airports, or international airline groups) hold sway over their regulators. By delegating regulatory functions to a less directly accountable, specialized agency that inevitably will recruit staff with relevant skills and knowledge from the industry being regulated, the risk of regulatory capture increases.<sup>5</sup> Further, removing the regulatory subject from the direct control of democratically accountable political actors could keep it removed from the public agenda, increasing regulatory “slack” in a way that invites capture.<sup>6</sup> Additionally, consolidation of all regulatory functions in one agency may lead to more regulatory capture than if regulatory duties were divided among multiple agencies.<sup>7</sup> One important countervailing factor in this regard could be the CAA’s primary duty to passengers; it is however not entirely clear how, if at all, the practical operation of this duty could be enforced.

Ultimately, the Bill is a necessary and largely successful updating of the regulatory apparatus for the aviation industry, and has received the broad general support of industry representatives, passenger groups, and even the regulator itself. The Bill conforms to the 2011 Principles for Economic Regulation.<sup>8</sup> While the aviation industry stands to benefit from some of the improved regulatory processes, it also needs to prepare to bear an even

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<sup>5</sup> See Estache & Martimort, *Politics, Transaction Costs, and the Design of Regulatory Institutions* 14–15 (World Bank, Econ. Dev. Inst., Reg. Reform & Private Enter. Div., Working Paper, 1999), available at <http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-2073>.

<sup>6</sup> See Michael E. Levine, *Regulation, the Market, and Interest Group Cohesion: Why Airlines Were Not Reregulated*, in *CREATING COMPETITIVE MARKETS: THE POLITICS OF REGULATORY REFORM* 215, 217–19 (M. Landy, M. Levin & M. Shapiro eds., 2007).

<sup>7</sup> See Estache & Martimort, *supra* note 5.

<sup>8</sup> U.K. DEP’T FOR BUS., INNOVATION & SKILLS, *PRINCIPLES FOR ECONOMIC REGULATION* (2011), available at <http://www.bis.gov.uk/assets/biscore/better-regulation/docs/p/11-795-principles-for-economic-regulation.pdf>.

greater share of the costs of that regulation. Finally, it is worth noting that the proposed improvements to the regulatory regime, while useful, entirely sidestep the U.K. industry's most pressing issue, the lack of competitive airport capacity. That issue probably will be addressed in the forthcoming draft policy framework for sustainable aviation, anticipated to be presented for public consultation in March 2012.

