

easyJet: summary of hearing, 17 May 2007

Background

1. easyJet told us that it regarded its relationship with BAA as challenging and not what it would expect from a competitive provider of services. Often the outcome of easyJet's discussions with BAA did not meet easyJet's expectations of a normal commercial negotiation. While it had a more open relationship with the Civil Aviation Authority (CAA) and easyJet was very supportive of the work the regulator had carried out to reduce prices at regulated airports, it had significant concerns about the CAA's approach to the de-designation of Stansted. It was also concerned that the CAA had focused on airport economics, and had made little effort to understand airlines economics and how this related to airports.
2. easyJet believed that Stansted had market power, and that the CAA's analysis was flawed. It had encouraged the CAA to take a closer look at whether new regulatory tools were needed, at Stansted in particular, to address the concerns about RAB-based regulation. As for Gatwick, easyJet took a different view of capital expenditure needs from that held by BAA. easyJet also indicated that there was greater scope for reducing operating expenditure at airports.
3. easyJet stressed that airlines operated in a complex market, and the market power of airports in particular should not be underestimated. Airports held significant power over their core local catchment, and in some situations used this to increase their prices, in the knowledge that airlines would have to continue using the airport to access its core catchment. The business model of low-cost carriers was particularly pertinent here. It involved the maximum utilization of aircraft and maintaining high load factors; airports knew this, and if an airline needed to base aircraft at an airport to access its market, the airport was guaranteed a significant volume of passengers.
4. easyJet told us that airports in south-east England were operating at or near capacity, and that combined with the airline's need to access airports' local catchments, this was a significant influence on their ability to increase prices, because the availability of excess and substitutable capacity encouraged competition. A similar problem, but to a lesser extent, existed in Scotland.
5. Appropriate consultation and the lack of commercially-based negotiation was an ongoing issue for the airline. One example of what easyJet highlighted as inadequate consultation by BAA was the recent introduction of new security standards.

easyJet's strategy

6. easyJet outlined its business model and its growth strategy, which was premised on continued growth across Europe, with more destinations and the development of more local flight bases to tap into local markets.
7. In terms of its strategy in the London area, easyJet said that travellers wanted a local service from their closest airports, rather than a hierarchical specification of certain airports for certain destinations or types of travel (ie long-haul or short-haul). This is why easyJet operated services to some destinations from three London airports. But Heathrow was not part of its network, because of operational constraints on air services from that airport, and its desire to maintain a low-cost flight model.
8. Part of easyJet's concern with the CAA's analysis of the market power of Stansted was that it ignored the low margins of the airlines when compared with the airport's

margin. The effect of this was that an airport was much more able to withstand a loss of passengers than an airline, giving it the upper hand when an airport was capacity constrained.

9. Another easyJet concern was the impact of increasing security requirements on the efficiency of short-haul travel.

Issues

10. easyJet questioned BAA's recent revision of its passenger forecasts, which would have a flow-on effect of increasing BAA's capital and operating expenditure plans. easyJet told us that BAA engagement and transparency had been lacking in this important process. It also questioned the broader BAA approach to managing growth at its London airports; it suggested that a model of 'Heathrow primacy' was still in vogue at BAA, in which London passengers were assumed to prefer travelling via Heathrow above Gatwick, and in turn preferred Gatwick above other London airports. In easyJet's view, passengers wanted a greater choice of airports so they could compare a range of travel options and find the one that suited them.
11. easyJet believed that the negative effects of RAB-based regulation, combined with a lack of discipline being imposed by the CAA, was generating excessive and unnecessary capital expenditure plans at BAA airports. One example of this perceived 'gold-plating' was the expensive passenger airbridge at Gatwick, when a tunnel might have been a cheaper option.
12. In terms of BAA's operating expenditure, easyJet said that the efficiency target proposed by the CAA was insufficient. It believed that there was more scope for spending reductions, and the 1 per cent target was very modest compared with the rest of the aviation industry.
13. easyJet outlined its concerns at the lack of a coherent framework within which BAA and the airlines could consider service quality and operating efficiency at airports. For example, easyJet had not seen a full cost-benefit analysis of BAA's plans to move to a shorter queuing model for security processing, and had concerns about the quality standard measure used for security queuing.
14. easyJet was concerned about the different quality levels between Gatwick's north and south terminals, and the balancing of development and resources at the terminals. This linked to the issue of how airlines could contribute fairly to the cost of current and future operations.
15. easyJet said that there were problems at Gatwick because of the difference in service quality and facilities at the north and south terminals. In terms of the south terminal, EasyJet told us that:
 - the terminal's baggage system was ageing and unreliable;
 - its passenger photo-capture system for arriving domestic passengers was too slow, which could create queues out of the building;
 - it took a year for BAA to provide basic shelter from the elements for these queuing passengers;
 - the air conditioning failed at the end of summer 2006; and
 - generally, the south terminal was in need of significant refurbishment.

16. A key concern about Gatwick was BAA's sudden increase in the proposed investment programme for the airport by an extra £300 million of capital expenditure over the original £422 million figure that BAA had consulted the airlines on. easyJet was unclear how these extra proposals emerged, as they were not subject to the constructive engagement process.
17. easyJet told us that there was a gap between BAA and easyJet's preferences for how the market for airport services should operate. As a major consumer of airport services, easyJet felt it should have a greater say in future development plans, rather than simply relying on BAA to provide what it believed to be appropriate services. easyJet said that it should be able to have more influence over airport cost structure development than it currently did, and that this would lead to more cost-effective pricing of airport services that would more closely match its own low-cost operating model.
18. easyJet pointed to the significance of Ryanair and itself at Stansted, where between them the two airlines generated the large majority of passenger traffic, but were unable to have any significant input into how BAA ran the airport or planned for future growth. easyJet told us that this problem was also evident in BAA's plans to increase the annual passenger cap and build a second runway at Stansted.
19. In terms of airport charges, easyJet was concerned that non-regulated charges, which formed a large proportion of airlines' expenses, were based on BAA forecasts to which airlines had had little exposure. easyJet would prefer a more transparent approach to information sharing so that it could determine how non-regulated charges related to regulated airport charges, and analyse the costs. easyJet also said that BAA's 1 April 2007 increase in per-passenger charges at Stansted, from £2.75 to £5.50, would cut into its own revenue and could affect the profitability of certain routes.
20. easyJet also discussed its proposal for differential charging regimes at Gatwick, with different rates for north and south terminal operations to reflect differences in service quality. easyJet believed that this proposal could encourage greater investment in south terminal facilities, and incentivize BAA to bring Gatwick services up to a more equal and higher level of quality.
21. easyJet told us that expansion of the type proposed at Stansted should occur only once it was economically viable, not just because an airport was at or near its capacity. easyJet argued that the risk inherent in the present expansion plans at Stansted was effectively being carried by itself and Ryanair, despite their concerns about its viability and appropriateness. Again, BAA consultation and transparency were perceived as lacking.
22. easyJet said that the CAA's approach to regulation at Stansted should not take the shape of the CAA proposals for a 'market-based price cap', seeing this as just a loose price cap, and that it had encouraged the CAA, without success, to develop new cutting edge regulatory tools.
23. If ownership of Heathrow, Gatwick and Stansted was to be split up, easyJet believed that close regulatory controls would still be required, to prevent local monopolies being formed. easyJet said that a break-up would not affect the level of investment capital available for individual airports to undertake required expansion and refurbishment plans, as investment in such projects was popular among backers.
24. easyJet would prefer greater transparency in other aspects of BAA's planning model to permit a clearer understanding of:

- the options BAA considered when determining its expansion plans for a second runway at Stansted;
 - the way in which price profiles were spread over the quinquennial period;
 - how traffic forecasts were calculated and how these forecasts affected price profiles and the overall cost of doing business at an airport; and
 - how measures of service quality were defined and interpreted.
25. As regards BAA's consultation on the proposed second runway at Stansted, easyJet told us that it would welcome the opportunity to consider the cost-benefit analysis of various runway expansion options with BAA, so as to arrive at the most cost-effective solution to growing passenger and flight numbers, but BAA did not want this level of engagement. Similarly at Gatwick, easyJet told us that agreements that it thought had been reached with BAA were now being superseded by different capital forecasts by BAA.
26. In respect of airports in Scotland, easyJet said that Prestwick did not act as a significant competitor to Glasgow or Edinburgh airports, although it had some influence on Glasgow's catchment. The constraints imposed by limited access to runway slots and aircraft parking at London airports were not replicated in the less congested conditions at Scottish airports.