

Summary of hearing with Department for Transport 5 June 2008

Department for Transport review of regulation

1. The review would be conducted by the Department for Transport's (DfT's) officials, and contractors and consultants hired by the DfT from Eversheds, who had produced the legal advice for Stansted, and CEPA. The panel was to advise the DfT in the conduct of the review, suggesting issues for the DfT to examine.
2. The Secretary of State had identified three key areas for the review to examine: the passenger experience; incentivizing investments; and protecting the environment. The review would assess, for instance, how to improve the passenger experience, then identify and assess a rationale for intervention, before looking at the tools available. For any intervention deemed necessary, there would be a number of options, some of which may include changing the regulatory regime, and some might be for the Government to make. The Secretary of State's objectives had been set out in her statement to the House which announced the review. The Secretary of State had written to the CAA to request advice on how the passenger experience could be improved.
3. The Pilling review was not specifically looking at economic regulation, though Sir Joseph might mention it. There was a report due during the summer.
4. In order to ensure some form of regulatory certainty, the DfT would not amend or change the price caps in place at Heathrow or Gatwick by the outcome of its review of regulation. These price caps would apply irrespective of who owned the airport.
5. The first public publication of the DfT's thinking would be in September, when it would make a submission to the CC. The DfT would then wish to wait until the CC's final report was published, and would take into account any recommendations based around the review of regulation. After these recommendations, the DfT would issue a consultation, following which the Secretary of State would examine the evidence and reach a decision on how to proceed.

Investment at Stansted

6. The DfT could not comment on the timing for the ministerial decision on SG1, though it would anticipate a decision within the next couple of months. There had been a mini-consultation on NOx emissions, though the DfT could not comment on the outcome, or say how that might impact the Heathrow runway 3 decisions. An inquiry on SG2, if it was called in, could last 12 to 18 months, though it would be difficult to give any guarantee or certainty at this point.
7. Many stakeholders seemed unhappy with some of the costs associated with a RAB-based price control and the associated incentives on the parties. The Secretary of State had said in her decision letter on de-designation that the CAA might like to consider other forms of regulating Stansted, which combined consumer protection while avoiding some of the costs of RAB-based regulation. As the Secretary of State's powers began and ended with the designation of airports, it was for others to take a view on the form of the price control.

2003 White Paper

8. The White Paper set out a framework for airport development and the airport operator was working towards the White Paper objective, so the DfT did not currently have a concern in this area. If the airport operator were to lose interest in delivering capacity, it was not clear what the DfT would do. The DfT had wanted to ensure that whoever owned BAA had the financial resources to undertake the investment laid out in the White Paper.
9. One of the generators of the White Paper had been the Terminal 5 planning inquiry, which took seven years to deliver one terminal. The rationale behind the White Paper was to give endorsements to some developments to facilitate those developments through the planning system. The White Paper aimed to strike a delicate balance between social, economic and environmental concerns.
10. If demand were not constrained, there might be a need for three new runways in the South-East, but this was not sustainable, so the desirable outcome was for two new runways. It was unlikely that the four-year delay in SG2 would cause a problem in the planning process. As the White Paper looked far ahead, it was likely that the timescales would end up being different from those anticipated. The White Paper had identified a type of infrastructure, or a particular piece of infrastructure, which needed to be developed.
11. One of the reasons for not overturning the Gatwick agreement of 1979 was that such agreements should provide comfort. However, the Government had made it clear that if a new runway at Heathrow was not possible, Gatwick remained an alternative and the land should be safeguarded. If Stansted and Heathrow were going ahead, it would be very difficult for an operator to obtain permission for a new runway before 2030 because the White Paper recommended only two new runways in the South-East.
12. The DfT discussed at length the features of the current planning regime which led to the T5 planning inquiry being so long, along with the impact of the planning regime on delaying investment in infrastructure. The White Paper was a way of facilitating investment. It was too early to say if it had succeeded or failed. By having a White Paper, the prospects of delivering capacity reasonably early might be better than without the White Paper, based on the experience of Terminal 5.
13. The Government's view was that it was desirable for the Government to set a policy framework for the delivery of major infrastructure projects because if it did not, the planning system meant that the project might not be delivered at all. Without a Government endorsement, BAA saw no hope of getting a third runway through the planning system. If an operator at Gatwick put forward a business case for a second runway, the Government would have to look at it.
14. The timings in the White Paper were indicative, not set in stone. Oil prices had risen significantly since the last time passenger forecasts were examined. Hence the forecasts were being examined in line with the DfT's policy of keeping the forecasts up to date, though these were long-term trend forecasts.
15. The DfT would expect the developers to pay for any expansion in airport capacity. It was for the regulator to determine how the money was raised at a regulated airport and how the developer was remunerated. It would be a decision for the operator whether Stansted needed facilities for A380s.

16. The Infrastructure Planning Commission, given Royal Assent, would not be operational until 2010. SG2 would therefore be dealt with under the current planning system, though this was unlikely to disadvantage the application. The major infrastructure project system had not really been tested. The White Paper had been ground-breaking, in giving a clear statement of policy. The Government had made a commitment to produce an air transport national policy statement, based on the White Paper, though this was unlikely to be available before the conclusion of the CC's inquiry. Any drafts produced might be shared with the CC.

Stansted de-designation

17. The criteria were ultimately a tool for the Secretary of State, who might take into account other factors. The CAA's argument was that people might drive for two hours to get to an airport, and that there were a number of airports within that time of Stansted. Some airports in the Midlands offered similar flights to Stansted. The DfT had looked at much evidence from the airlines, particularly Frontier's analysis for easyJet which showed a strong preference for the local airport, and also at an output from the Department's own modelling which studied how passengers move between airports in the South-East and elsewhere. This analysis had been provided to the CC.
18. The DfT had broadly concluded that when the airports in the South-East were not capacity constrained they were close substitutes for each other, but that Birmingham and East Midlands were very weak substitutes for Stansted. Switching costs seemed to be reasonably low for a couple of aircraft, but extensive when moving based aircraft. The DfT had concluded that Stansted was moving towards the direction of having substantial market power, but was perhaps not quite there yet. The quality of evidence from the airlines on switching costs had been of varying quality.
19. The DfT did not have a view on the CAA's six options. The DfT was not clear how Terminal Development Tendering would work in practice and believed that some of the options seemed similar to each other. However, it was seen as a matter for the CAA and the CC to decide. It was as yet unclear what effect any divestment would have on the regulatory system. One of the strands around the review would be looking at how to best fulfil environmental objectives, so some form of regulation might, in principle, be required. Ongoing regulation might be encouraged by airlines because it provided free benefits to them as they did not have to debate capex or opex with the airport, but instead left the regulator to undertake such tasks.

Traffic forecasts

20. The latest available traffic forecasts from the DfT's model were published alongside the Heathrow consultation and were six months old. Revised forecasts would be published alongside a decision on Runway 3. If oil prices rose, the forecasts might fall, but it was not yet clear what price would be input into the model. If it was accepted that the airline industry was broadly competitive, it would pass through the increased fuel costs. If the oil price rise was transitory, and the airlines had cash, it might not be passed through.
21. Vivid Economics' work had demonstrated significant cost pass through, the precise extent depending on the demand curve assumptions. If oil price rises were temporary, there could be a temporary disturbance in demand, followed by a reversion to trend. The DfT had not yet taken a view on whether the recent oil price increases would be sustained or not.

22. Stansted might have considerable scope for developing business traffic. Because of the differing models of long-haul carriers and point-to-point no frills carriers, it might be necessary to set the airport up slightly differently. For long-haul flights dwell time was important for the operator, since such customers tended to spend more money, wait longer in the terminals and to expect a different degree of service. Longer runways were more useful because they could handle heavier aircraft, but this might not make a difference to the DfT's case for a second runway at Stansted, which was predicated on huge excess demand in the South-East.
23. The DfT had seen BAA's Stansted forecasts which were run in a different way from theirs, as the DfT's were top down and BAA's were bottom-up. The DfT had not seen a full finance business case for the expansion. It was a matter for BAA to develop its business case.

Cargo

24. The DfT stated that Stansted served an important role for cargo in the South-East as it was almost the only dedicated cargo facility. However, it had heard that some airlines would rather fly their aircraft to Gatwick than Stansted. The DfT was forecasting that freighter ATMs would grow at Stansted which would mean that Stansted would keep its share of freight ATMs broadly constant, increasing from 17 per cent in 2005 to 19 per cent in 2030. The DfT agreed to furnish the basis of these forecasts.

Other questions

25. The DfT had compared a social case model with a business case model, asking which components of the social business case would be relevant in the financial business case. The conclusion was that many would be relevant, but many would not. A social discount rate was 3.5 per cent, but BAA might use a rather higher rate for its financial calculations.
26. The DfT agreed to share its forecasts from any new modelling with the CC. It was not clear to the DfT that the CAA had characterized its deliberations on the Stansted de-designation issue as accurately as it could have done. The DfT also planned to make its view of the impact of the White Paper plain.