

## Summary of hearing with London Luton airport 17 June 2008

### Market outlook

1. The outlook for airlines at Luton seemed difficult but not bleak for the remainder of the calendar year. Silverjet had gone bankrupt at the end of May, and some of the Eastern European airlines did not appear to be financially robust. Even Ryanair and easyJet were under pressure from high oil prices. From next year, if fuel prices had not declined, the position would be very difficult for all the airlines. [redacted] Fuel costs for them might be £20/seat.

### Luton's competitive position

2. Luton saw Stansted as its main competitor, for three reasons. Firstly, a large catchment overlap; secondly, a high degree of route overlap; and thirdly, a high degree of airline overlap, though not much movement of aircraft seemed to take place between the airports. Neither Stansted nor Luton had any overnight capacity. Luton did not have access to detailed price information about Stansted, nor did Stansted about Luton. Airlines generally respected detailed confidentiality, but nevertheless negotiated their position on price. Luton, however, believed itself to be less expensive than Stansted for airlines.
3. The price differential required to justify moving aircraft might be considerable for a small airline. Costs included sunk marketing costs, systems costs, redevelopment of marketing equities and people costs, and there might be a significant risk premium. It was also necessary to bear in mind that the new routes might not work. Marketing was the largest component of the costs of moving a route, though money spent on attracting people to Luton might not be completely wasted if the airline moved to Stansted because the catchment areas overlapped.
4. If crew were based at the old airport, the costs of moving them would be higher. A based aircraft might need to fly at 6 am, meaning that the crew would have to be on site at that time, and hence would need to live near the airport.
5. When airlines considered moving, the debate did not focus around airport charges, but around passenger numbers and yield. Luton stated that airports did not have monopoly power, but that airlines had oligopoly power, particularly where there was surplus capacity. However, when capacity was constrained, the debate was likely to be more balanced.
6. Whilst management always read articles in the press when airlines complained about excessive pricing, Luton did not have access to pricing at other airports.

### Contracts with airlines

7. Luton had [redacted] contracts with easyJet and Ryanair, with parts of the price fixed and other parts variable. The airlines always wanted prices to be as fixed as possible. However, there were always eventualities for which the airport could not plan, such as legislation for security. [redacted]. The benefit of such a contract to an under-utilized airport was that it was difficult to move planes once they were based there. [redacted]
8. The easyJet contract had been a successful one for Luton, and Luton believed that it had also been beneficial for the airline. [redacted]

## **Impact of price caps at other BAA airports**

9. There did not appear to have been much impact of the new price caps at Heathrow and Gatwick on Luton, since traffic was shared between the airports to a limited extent, though a few airlines had commented to Luton that Gatwick was becoming expensive and congested. People travelling to or from the Midlands or North London might perceive that it was more convenient than Gatwick, but for those travelling to or from South London, Gatwick would probably be preferred.
10. For Stansted, the recent increase in charges had been profitable to BAA, but there had been a reduction in traffic levels, apparently related to the increase in charges as well as to fuel prices and the recent downturn in the economy. If Stansted were de-designated, it would be difficult to see a large increase in charges being welcome to airlines in the present climate. It would be difficult, however, for Ryanair and easyJet to pull out of Stansted and stop serving London, though if it were cheaper for them not to fly, they might substantially reduce flying. Airlines had less bargaining power in a constrained environment than in a non-constrained environment.

## **Marketing**

11. Luton's marketing fell into three categories: business-to-business marketing, particularly for off-peak capacity; a little on consumer marketing, mostly to persuade consumers to engage with retailers; and a very small amount to persuade consumers to go to the airport. Luton did not market the Luton brand aggressively. Luton had not exploited the difficulties at Terminal 5 in its marketing effort, but some airlines had. Though some of Luton's airline customers wanted it to market itself more, Luton did not believe it would be effective due to people's general view of airports.
12. Luton believed it had a reasonable sense of where opportunities were, and that unusual ideas rarely worked. It used business-to-business marketing tools such as conferences and commented that price was not usually part of the opening discussion. People would come from further afield for unique route propositions and for low-cost carriers the critical selling point from an airport was the speed of the turnaround, while for more corporate customers the atmosphere of the airport was more important. There was some, albeit relatively small, catchment overlap, and hence a degree of competitive tension existed with Birmingham and, to a lesser extent, East Midlands, and the airlines would seek to play the airports off against each other.

## **Capacity**

13. Luton's capacity constraint was partially in stands, but adding six more stands would require more check-in desks and security capacity. Late evening return of the planes would also mean a need for more baggage reclaim and immigration capacity. However, Luton would like to expand if it could bring discussions with Luton Borough Council to a satisfactory conclusion. Prices at Stansted were a factor in Luton's investment decisions, though the important issue was what the airlines would pay.
14. The White Paper's vision of a 30 million passenger airport at Luton would have been hard to deliver politically and it did not work commercially since Luton only had a 30-year concession to 2028 and obtaining the required return in that time was not feasible. However, it would not have been impossible to sell politically. The break clause in the lease significantly complicated making large investments before that date, especially given the currently challenging market environment. Luton was currently attempting to resolve the situation with the Council. Presently it was growing

at 7 per cent a year off-peak, where there was plenty of capacity at the airport, and there was demand from airlines for more overnight capacity. [REDACTED]. The oligopoly power of the four big airlines at Luton was balanced to some extent by the cost to them of moving their planes. It was also quite difficult for them to leave if they had demonstrated that a route worked, since another airline might benefit from their investment.

### Capacity increases and prices

15. The incremental cost approaches to the Stansted price control were similar to the approach Luton was using to price investment itself. Luton's challenge in expanding capacity lay in maintaining the balance of its sub-systems. Keeping the cost growth incremental was not easy. It was difficult, however, to see how the price would immediately increase at Stansted if the price cap were removed, given current conditions. If Ryanair grounded 20 aircraft over the winter, the extent to which airline power at Stansted could be exercised would be tested. [REDACTED]. This year passenger numbers at Luton would be around 10.4 million. Growth this year had been driven by inbound traffic, and looking forward in the short term, growth was expected to be [REDACTED] per cent annually and to come from the same source.
16. Luton would like to increase its charges, but it had long-term contracts with its two largest customers. [REDACTED]. Luton was trying to [REDACTED] persuade airlines not to park aircraft because space was limited.

### Operations and commercial revenues

17. There was unlikely to be much difference between Luton and Stansted in efficiency. Certain airlines had told Luton that it was better than BAA airports, though this might be expected as its airfield was relatively small and it was not quite as busy. Luton aimed for ten minutes as a maximum length for security queues and last summer the average length had been 7.5 minutes. However, sometimes the queues in the early morning were 14 or 15 minutes.
18. Luton had recently installed new software which used Bluetooth to measure security queues in real time. It had contracted it in from a third-party company and no other airport used it. Security was not outsourced, [REDACTED].
19. [REDACTED] Luton had service level agreements with the airlines, and the airlines had them with the ground handlers. These agreements covered availability of check-in desks, baggage system, security provision, etc. [REDACTED] Luton also measured customer satisfaction through the ACI survey and a new quantitative survey delivered by Pragma.
20. Luton's commercial revenues were about the same as its aeronautical revenues. [REDACTED]

### Cargo

21. Cargo had been increasing until three months previously, but had since slowed down. Silverjet had stopped and [REDACTED]. For cargo, Luton saw itself as an overspill airport for those who could not obtain access to Heathrow. There were only two cargo stands at Luton, [REDACTED]. For cargo, Luton was close to Heathrow and East Midlands which were large cargo airports.
22. [REDACTED]

## Other questions

23. Given the break clause in the lease, it was not obvious why Luton would invest significantly in an additional runway and extra terminal capacity before that situation was resolved.
24. 70 per cent of the routes served by Luton were shared with at least two other London airports. At the route level, the competition was greater with Heathrow than with other airports. As almost a third of Luton's traffic came from outside the South-East, its market was wider than simply that area. Some people seemed to travel from [✂] for the right flight.
25. Passengers were checking in the same amount of baggage as before the one-bag rule. [✂] It would be interesting to see how this evolved over the next few years.