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FAO: Ms Susie Talbot
CAA – ERG
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London WC2B 6TE

Dear Ms Talbot

Consultation on the framework and options for the economic regulation of Stansted Airport

Introduction

1. Stop Stansted Expansion ('SSE') welcomes the opportunity to comment on the above and apologises for being a few days late with this response. The consultation period was relatively short for commenting on regulatory proposals some of which would mark a radical departure from the arrangements which have operated for the past 20 years. In addition we wished to digest new, highly material information which became available only last week with the submission of BAA's planning application for a second runway at Stansted ('the G2 project') and the publication of BAA's 2007 financial report including segmental financial results for Stansted.
2. We should make clear from the outset our concern that the CAA's starting point for this consultation, namely its firm view that Stansted will not have substantial market power in Q5, results in a predisposition on the part of the CAA to relax its approach to economic regulation at Stansted. We do not understand why the CAA, having viewed regulation as necessary at Stansted over the past 20 years (when Stansted had little or no market power) should decide that regulatory price caps are no longer of great importance at the very moment when the tables have turned. Stansted is now able to price right up to the cap in the certain knowledge that its airline customers have no real option but to pay.
3. We find it surprising that the CAA is not prepared to accept the conclusions reached by the Secretary of State in January 2008 on the de-designation issue. We presume that before reaching her decision the Secretary of State took careful account of the CAA's evidence and views as well as a substantial body of evidence and views to the contrary, including from SSE, and of research and analysis undertaken by her own department. There is no need to revisit all the arguments and evidence about de-designation here. The key point is the instruction following on from the Secretary of State's conclusions:
"I am therefore asking the CAA to continue to protect passengers by setting price caps at Stansted until new capacity is delivered or until further evidence emerges from the ongoing Competition Commission review."

However, instead of focusing on its role of protecting passengers, the CAA's focus appears to be on protecting BAA and facilitating the delivery of the G2 project.

4. The CAA's statutory duty in relation to investment is *"to encourage investment in new facilities in time to satisfy anticipated demands by the users of such airports."* It follows that it is not part of the CAA's duty to encourage premature investment at airports or investment which fails to satisfy the demands of users. In addition, this duty must be weighed alongside the CAA's other statutory duties including *"to further the reasonable interests of users of airports within the UK"* and *"to promote the efficient, economic and profitable operation of such airports"*.
5. In attaching priority to the development of the G2 project during Q5 the CAA is acting inconsistently with its statutory duties. A second runway is not required until towards the end of Q6 at the very earliest. The forecasts submitted on behalf of the airline users of Stansted ('LACC') to the 2007 G1 Public Inquiry (relating to capacity increases on the Stansted runway) demonstrate this, as follows:¹

Stansted demand scenarios by reference to increases in airport charges

Year	Optimistic projection (mppa)			Realistic projection (mppa)		
	Unconstrained demand	Low elasticity to airport charges	High elasticity to airport charges	Unconstrained demand	Low elasticity to airport charges	High elasticity to airport charges
2017	44.8	35.7	28.6	36.9	30.5	24.3
2018	46.2	36.8	29.6	38.1	31.4	25.1
2019	47.7	38.0	30.5	39.3	32.4	25.9
2020	49.2	39.2	31.5	40.6	33.5	26.8

The column showing 'Low elasticity to airport charges' under the 'Realistic projection' is likely to be the closest to a mid-range forecast. This predicts demand of 30.5mppa in 2017 rising to 33.5mppa in 2020. Under the 'Optimistic projection', the prediction is for 35.7mppa in 2017 rising to 39.2mppa in 2020.

6. BAA's latest published traffic forecasts (as reproduced at Table 7-2 in the consultation document) predict 45mppa by 2017/18. However, circumstances have changed since that forecast was produced last year and it is expected that the new BAA forecasts to be published at the end of next month will trim this projection. Stansted passenger and freight traffic have both declined over the past year and the current economic outlook is considerably less optimistic than it was 12 months ago.
7. However, even if 45mppa were to be reached at Stansted by 2017/18, the airport is capable of handling such capacity without a second runway. (Whether or not this is desirable is another matter.) In addition, BAA has advised that the G2 project could be completed within four years following the grant of planning approval. There is therefore no justification for forcing users to fund c£1.1bn² of G2 costs during Q5 when (a) there is no need for G2 until the fourth year of Q6 at the very earliest; (b) planning permission is an uncertain prospect; and (c) even if planning permission were to be granted (during 2010/11 at the earliest) it is doubtful that BAA would then immediately press ahead with the development – although naturally BAA will seek to create the expectation that it will.
8. BAA told the G1 Public Inquiry that it estimated the capacity of Stansted's runway to be about 41mppa by 2021 (an underestimate in our view) and that it reserved the option of

¹ G1 Public Inquiry Proof of Evidence ACC/11, Table C.3.

² Consultation document, Table 7-5. Note that £1.1bn is at 2007/08 prices and excludes any allowance for construction price inflation.

submitting another planning application for further expansion on the existing runway beyond the 35mppa cap that it was prepared to accept at the G1 Inquiry.³ In the context of first making best use of existing capacity, we draw the CAA's attention to the clear Government policy statement set out in 'The Future of Air Transport' White Paper ('ATWP'):

*"The first priority is to make best use of the existing runways, including the remaining capacity at Stansted and Luton."*⁴

9. We also draw the CAA's attention to the shift in the Government's views on the timing of a second Stansted runway from:

*"as soon as possible (we expect around 2011/12)"*⁵

in the December 2003 ATWP, to:

*"The timing and nature of development at Stansted remain a commercial decision for the airport"*⁶

in the December 2006 ATWP Progress Report

10. It is in the light of all of the above that we question the CAA's focus on encouraging the premature development of the G2 project during Q5. We believe this is inconsistent with any proper weighing of the CAA's statutory duties and amounts to the CAA aligning itself too closely with the interests of the airport operator.
11. This unbalanced approach in the CAA's weighing of its statutory duties manifests itself in the consultation document in its clear preference for the two options which would provide least protection for airline users. It is also evident in the manner of presentation of the options – even to the extent of including misleading evidence. An example of this is the CAA's reliance on Stansted's relatively low profitability in the past as justification for its stance, even when it is well aware that Stansted's fortunes dramatically improved with effect from 1 April 2007 as a result of the unwinding of historic discount agreements on 31 March 2007. BAA financial results for 2007 show that Stansted achieved a 61.5% year-on-year increase in aeronautical charges per passenger and a 66.7% increase in operating profit.⁷ In seeking to assess Stansted's future financial performance, 2007 is clearly the most appropriate baseline to use and earlier years are largely irrelevant.

Comments on the CAA options

The augmented building-block approach (Option 1)

12. This is described by the CAA as the standard building-block approach but with greater regulatory oversight of the investment programme. This option would almost certainly require the CAA to become heavily involved in settling disputes between the airport operator and its airline customers. While understanding the CAA's apprehension about the additional workload that would arise if the augmented building-block option were to be adopted, we believe that this option would provide more effective regulation than the standard building-block approach and it is therefore preferable to the status quo.
13. We do not agree that the augmented building-block option would be inconsistent with the CAA's duty *"to impose the minimum restrictions necessary."* This simply means that the CAA should not impose unnecessary restrictions.
14. The fundamental area of dispute between the airport operator and its customers is the design, specification and cost of the G2 project and so a difficulty with this option is that

³ G1 Public Inquiry Core Document CD/523.

⁴ ATWP, Executive Summary, page 13: 'South East England', third bullet point.

⁵ Ibid, para 11.11.

⁶ ATWP Progress Report, Dec 2006, para 5.14.

⁷ BAA Ltd Financial Report 2007, tables on pages 6 and 8 respectively.

BAA has now submitted its G2 planning application. This situation has arisen because more than a year has been wasted in travelling down the garden path of de-designation without a parallel (contingency) path to consult stakeholders on Q5 regulatory options.

15. If the augmented building-block option were to be adopted and implemented effectively, the G2 application would need to be withdrawn so that it could be subjected to proper negotiation between the airport operator and its airline customers with the CAA acting as referee in the last resort. As we have explained above, there is no market need for G2 until towards the end of Q6 at the earliest. There would therefore be no time penalty if the current planning application were to be withdrawn so as to provide an opportunity for negotiation with users and CAA intervention if necessary. The augmented building-block approach should certainly not be discounted on the ground that it has been pre-empted by BAA as a result of its very recent submission of the G2 planning application.

Legacy price caps (Option 2)

16. We believe that the CAA has overstated the difficulty of establishing and maintaining a dividing line between legacy assets and new operations. The simplest approach in our view would be to establish a separation between full use of the existing runway and the G2 project. The G2 project is virtually a second Stansted airport. The runway would be some 1.5 miles from the existing runway, served by its own terminal and by largely independent facilities. A degree of judgement would be needed in relation to certain shared facilities and operating costs but we do not believe it is beyond the wit of the CAA to arrive at fair and sensible rulings on such matters if and when the airport operator and its airline customers could not agree.
17. The legacy price caps ('LPC') option would enable G2 expenditure to be ring-fenced in a separate RAB. The investment would be remunerated by revenues from future users of G2 and there would be no pre-funding by users of the existing runway. This would align regulation more closely with the real world commercial environment where the risk lies with the investor and it would be more likely to ensure that the project was market-led and based on a sound business case. Insofar as the objective of regulation is to act as a proxy for a competitive, real world environment, the LPC is superior to the other options because it would come closest to meeting that objective.
18. The CAA cites BAA's intention, in the event of a second runway, to operate the two runways in segregated mode as posing a complication in relation to the LPC option. However, it should be noted that the ATWP did not envisage segregated mode. It specifically supported a wide-spaced runway configuration with a capacity of about 81mppa.⁸ It is BAA who has proposed a mode of operation whereby all take-offs would be from one runway and all landings on the other. The 68mppa capacity which BAA states could be achieved with its G2 proposal could in fact be achieved with a narrow-spaced option, at lower cost and substantially less land take.⁹ In any case we do not believe the 'cross-over' issues arising from BAA's preferred mode of airport operations would be a particularly difficult regulatory issue to resolve. A *quid pro quo* solution has intuitive appeal and, although we have not researched the matter fully, we would be surprised if such a proposal would fall foul of UK or EU legislation.
19. The CAA also cites grandfathering of slots as a potential problem with the LPC option because it could encourage uneconomic and inefficient use of the airport in the short to medium term. Grandfathering need not of course be based on slots. It could be based on passenger numbers or some other formula agreed between the airport operator and the airlines under the auspices of the CAA. This is a point of detail, not a showstopper.

⁸ ATWP, paras 11.11 and 11.27.

⁹ 'A Regional Air Services Study for the South East and East of England – Report on behalf of the DETR', BAA, March 2001 (Vol 1) and April 2001 (Vol 2).

Terminal development tendering (Option 3)

20. The terminal development tendering ('TDC') option has the strong attraction of creating a more competitive environment. There is no doubt that this option would give rise to a number of practical problems but that does not justify dismissing TDC at this stage.
21. The consultation document states (para 9.40) that *"without BAA's consent, it is unclear whether the current regulatory framework would allow this approach to be adopted."* We are surprised that the CAA did not seek to clarify the legal position and publish its advice before consulting on this option. There is little point in seeking to address the practical problems which would arise from TDC until we know whether it is legally possible.
22. Just as in the case of Option 1, Option 3 should not be discounted on the ground that it has been pre-empted by BAA as a result of submission of the G2 planning application.

Market-led price cap (Option 4)

23. We have serious reservations about the option of a market-led price cap ('MLPC'), not least the feasibility of being able to arrive at an appropriate MLPC based on either yield or charges comparisons with other airports. Even if reliable data could be obtained from 'comparable' airports, such comparisons would be fraught with difficulty. Service, quality and efficiency standards would need to be taken into account in trying to arrive at a like-for-like dataset and, whether on a charges or yield basis, proper comparability would require regular airport surveys to establish the price of everything from a cup of coffee to a car parking ticket and the quality and efficiency of the service provided.
24. A further difficulty with the MLPC option arises because of the common ownership of Heathrow, Gatwick and Stansted. Whether by accident or design BAA's price sensitive traffic is served by Stansted and its premium traffic by Heathrow. At a corporate level it may well be an entirely satisfactory arrangement for BAA to accept a lower level of profitability at Stansted insofar as this helps to safeguard its higher margins at Heathrow. However, an airport which is not part of a segmented monopoly system has to cater for the market as a whole. The implication of the MLPC option is that Stansted would be allowed to 'level up' to the prices charged or yields achieved by generic regional airports. We submit that this would be entirely inappropriate.
25. Our main concern about this option is, however, the fact that it would provide the CAA with too much discretion in setting the MLPC and, in view of the CAA's stated position that there is no real need for price caps at Stansted, it is reasonable to expect that the CAA would err substantially on the high side. In effect it would be 'de-designation by the back door' and would fail to provide an adequate response to the Secretary of State's instruction to the CAA in January 2008 *"to continue to protect passengers by setting price caps at Stansted."*

Precautionary price cap (Option 5)

26. If the MLPC option can be characterised as 'de-designation by the back door' then the precautionary price cap ('PPC') option amounts to abrogation of the CAA's responsibility for the economic regulation of Stansted. We are not at all persuaded that the general framework of UK and EU competition law could provide adequate protection against abuse of market power. In the case of a monopoly provider, competition law can provide a complementary level of protection but it cannot be an adequate substitute for effective regulation. If the CAA were to believe otherwise then the PPC approach should have been applied at Heathrow and Gatwick also.

In concluding we cannot avoid making the observation that, having taken a close interest in the CAA's regulatory role over a period spanning the Q4 and Q5 regulatory reviews, we detect a marked shift in the CAA's position over the past year or so towards protecting the interests of the airport operator. While we cannot claim to be an entirely objective observer we carry no candle for either the airport operator or its airline customers and therefore leave you to make what you will of this observation.

Yours sincerely

Brian Ross
for Stop Stansted Expansion