

Manchester Airport PLC

A report on the economic regulation of Manchester Airport PLC



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**Presented to the Civil Aviation Authority
October 2002**

Members of the Competition Commission as at 25 October 2002

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¹These members formed the Group which was responsible for this report under the chairmanship of Professor P A Geroski.

Note by the civil Aviation Authority

In accordance with section 45(7) of the Airports Act 1986, the Secretary of State for Transport has directed the CAA to exclude from the published report certain matters, publication of which appear to the Secretary of State to be against the public interest or the commercial interests of a person. Accordingly certain figures and text have been omitted.

The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Part I

Summary and Conclusions

1 Summary

1.1. Under the reference made by the Civil Aviation Authority (CAA) on 28 February 2002 (see Appendix 1.1) we are required to investigate and report on:

- the maximum level of airport charges that may be levied by Manchester Airport PLC (MA) during the five-year period that begins on 1 April 2003;
- whether, at any time between 10 December 1996 and 28 February 2002, MA has pursued a course of conduct which has operated against the public interest, or might be expected to do so, in relation to the airport charges it has levied; and
- whether it or one of its associated companies has, during the same period, pursued a course of conduct which has operated against the public interest, or might be expected to do so, in relation to any operational activities carried on relating to Manchester Airport, or to the granting of a right to others to carry on such activities.

1.2. During the current quinquennium, the maximum revenue per passenger from airport charges was set to change each year by no more than 5 per cent less than the movement in RPI (RPI-5). In practice, airport charges at Manchester were below the price cap for much of the period, though many unregulated charges did increase at a rate greater than that of the RPI. The rate of growth in passenger numbers exceeded projections in the first three years of the quinquennium, but then fell back in the last two, following the events of 11 September 2001. In 1998/99 17.4 million passengers used Manchester Airport. The projected total for the current year is 18.3 million.

1.3. For the coming quinquennium, we have chosen an approach to the setting of airport charges which broadly follows that adopted by the Monopolies and Mergers Commission (MMC) in its previous reports on Manchester Airport. This means that, while we have considered very carefully the CAA's proposal that the regime should change to one based on a dual till—ie one concerned solely with costs and revenues associated with aeronautical activities—our conclusion has been that the maximum level of airport charges at Manchester should continue to be calculated on the basis of a single till. So in considering the price cap for airport charges over the next five years we have also taken into account projected costs and revenues from Manchester's commercial activities at the airport. In addition, we have decided to recommend that the current arrangements, by which Manchester can pass through to airlines additional security costs that arise during the course of the quinquennium, should be retained.

1.4. As for the key components that go into the calculation that we needed to make, to fix the maximum level of airport charges for the next five years, we concluded that:

- as the Manchester Airport Group has significantly changed its corporate structure since the last MMC review, certain of the costs, revenues and assets of other group entities associated with the airport should be included in the till, along with those of MA.
- 7.5 per cent is the appropriate cost of capital for Manchester, which should be applied to capital expenditure during the period and to the regulatory asset base, which Manchester has projected to be £703 million (in 2001/02 prices) at 1 April 2003.

- The provisions for staff costs and for other operating costs should, by and large, be those assumed in Manchester's own plans, but no more than £6 million a year (at 2002/03 prices) of spending on unpublished discounts at Manchester should be taken into account in setting airport charges.
- The projected revenues from unregulated charges and from retailing, car parks and property rental should be those submitted to us by Manchester—including the rent derived from the office accommodation located at the Ground Transport Interchange.
- The passenger forecast should be that submitted to us by Manchester.
- The figures for capital expenditure should be those submitted to us by Manchester, except for some changes to expenditure relating to the second runway, which we are recommending should provide for costs to be passed through to airlines in certain circumstances.

1.5. On the basis of these assumptions, we have recommended that the maximum revenue per passenger for airport charges should be £5.90 in 2003/04 at 2001/02 prices, dropping to £4.15 at the end of the period (on the same price base). This equates to a reduction relative to the RPI of some 8.9 per cent a year throughout the new quinquennium, and means that, in the first year, airlines will pay 65p less per passenger—and, in the final year, £2.40 less—than in 2002/03. Under the CAA's proposals, airport charges would have remained at broadly their current level throughout the period; so there would have been no comparable savings to airlines. We do not expect that our proposals will lead to any financing problem or to the postponement of any necessary investments at Manchester Airport—though if external events were substantially to reduce Manchester's ability to achieve the expected level of return, then it would be open to the CAA to reconsider the price cap we have proposed, during the course of the next quinquennium.

1.6. Not all of the reduction in airport charges that we have recommended will be a net benefit for airlines. Part of the reduction derives from a decision to recover some of the costs currently associated with baggage security by means of unregulated charges, and there is the potential for further charges being imposed on airlines during the next five years to cover additional costs that Manchester may be able to pass through in relation to security and to the second runway. Had it not been for these items, the annual reduction, in relation to the RPI, would have been 7.8 per cent.

1.7. We received widespread complaints from airlines that Manchester had failed to put into operation adequate procedures for managing service quality during the period up to the start of our inquiry. Although there are a number of indications that MA is now seeking to address these concerns, we have concluded that, in failing to conduct itself so as to make prices paid reflect levels of service to a far greater extent, it has pursued a course of conduct which has operated, and might be expected to operate, against the public interest. The adverse effect of this conduct is that prices do not reflect the quality of service to the extent that would otherwise be the case and in consequence that there is an absence of the financial incentive to provide the quality of service which would obtain in a competitive market. So we are recommending that the CAA remedy the situation by imposing a condition.

1.8. We understand that, because of the consultation procedures that it must follow, the CAA will not be in a position to impose any conditions until the beginning of February 2003. This consultation period will give MA an opportunity to agree a full and effective generic service standard (GSS) regime in respect of a number of services we have identified. The recommended condition would require MA to comply with all such agreements that have been made before the date of the condition. The condition would deal with any such services that are not then covered by agreements by requiring MA to make specified rebates whenever specified levels of service were not met. The amount of the rebates and the levels of service would be specified in the condition, which could contain provision for exceptions.

1.9. The condition would also make provision for monitoring and reporting. Thus the CAA would, in effect, be imposing a set of GSSs. Our report contains guidance as to how the CAA should do this.

1.10. While we have made no other public interest findings in this inquiry, we have recommended that the conditions relating to cost information and consultation that the CAA imposed on Manchester following the last MMC report should be extended into the coming quinquennium.