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Department for Transport  
Zone 1/28  
Great Minster House  
76 Marsham Street  
London SW1P 4DR

Dear Sirs

### **Consultation on the Status of Stansted Airport**

We wrote to you on 18 April 2007<sup>1</sup> in response to your consultation on the proposed criteria for (de)designation of airports. We are now responding to the above consultation, which follows on from the revision of the de-designation criteria and deals more specifically with the status of Stansted Airport. We hope you will take note of our comments although we are not on the list of stakeholders invited to respond and were not sent the relevant documents. We have of course been able to obtain the documents from your website.

This response is based on our 18 April response. We apologise for not providing this in the form of answers to the 17 specific questions raised. (As you are aware we are currently very involved in the Stansted G1 Public Inquiry and our resources are stretched.) However, our response does address the main points upon which you are seeking views in this consultation.

- 1 We support the principle of airport de-designation but we believe that it would be premature to de-designate Stansted at this stage. In our view the timing of this proposal is driven by the DfT's desire to assist the airport operator in the development of a second runway at Stansted as soon as possible, recognising that it is not possible for the airport operator to fund a second runway at Stansted on a commercially viable basis whilst price controls remain in place (at least in their present form).
- 2 It is clear that the DfT's intent is to release the CAA from its duties under Section 39 of the 1986 Airports Act to regulate airport charges at Stansted thereby allowing prices to rise and giving the Secretary of State's policy in relation to second runway at Stansted a better prospect of success. We view this as an attempt to circumvent the safeguards that were put in place by Parliament to prevent unfair competition and abuse of market power following the privatisation of BAA in 1987 as a single entity thereby leaving it in a dominant market position in the south east (92% of the market) through its ownership of Heathrow,

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<sup>1</sup>Letter dated 18 April 2007 to Mr Eric Weinstein at the DfT.

Gatwick and Stansted airports.

- 3 Section 2, page 20 of the 1987 BAA privatisation prospectus<sup>2</sup> ("the Prospectus") stated:

*"Heathrow, Gatwick and Stansted airports have been designated by the Secretary of State for economic regulation purposes under the Act." and "It is open to the Secretary of State to designate other BAA airports."*

The Prospectus then went on describe the nature of economic regulation, i.e. price control, and listed the CAA's statutory duties in this respect, as defined by Section 39 of the 1986 Airports Act. It is also worth noting that the Prospectus made no mention of the possibility of any of the designated BAA airports (listed as Heathrow, Gatwick and Stansted) being de-designated.

- 4 The designation of Stansted over the past 20 years has been meaningless in terms of price control because Stansted has had no market power and has not, until this year, been able to price up to the level permitted by the regulatory cap. Stansted has benefitted from designation over this time because designation has enabled it to enjoy the benefit of cross-subsidy from Heathrow and Gatwick users. It would be perverse if Stansted were now to be removed from the regulatory framework just at the moment when it has finally got some market power. The DfT is, in effect, proposing that an arrangement which has distorted the market over the past 20 years should now be reversed so as to enable market distortion to continue into the future.
- 5 The likelihood of Stansted having significant market power over the next 10 years or so should not be in doubt at the DfT. In 'the Air Transport White Paper ('ATWP')'<sup>3</sup> much was made of the shortage of airport capacity in the south east, for example:

*"Because we expect there to be an increasingly severe shortage of runway capacity at the major South East airports over the remainder of this decade, making full use of the available capacity at Stansted will be essential to avoid stifling growth."*<sup>4</sup>

- 6 Quantification of the capacity shortage can be arrived at by examining the DfT's demand and supply analysis in the ATWP and its supporting documents such as "Passenger Forecasts: Additional Analysis", published concurrently with the ATWP, as well as in the consultation documents leading up to publication of the ATWP. In addition, the recent ATWP Progress Report<sup>5</sup> confirms the DfT's view regarding the shortage of airport capacity in the south east, specifically referring to "*the congested south east*"<sup>6</sup> and confirming the expectation that demand will continue to outstrip supply:

*"Our new forecasts remain fully in line with what we said in 2003."*<sup>7</sup>  
*"... the additional airport development supported in the White Paper would not be sufficient to support all of this unconstrained demand."*<sup>8</sup>

- 7 Given the DfT's view that capacity in the south east is insufficient to meet present and future demand to 2030, the de-designation of Stansted at this time would clearly lead to higher airport charges than would be the case if Stansted was subject to price control. BAA would be able to raise prices and generate significant additional profits which, it would appear, the DfT intends would accrue directly to the airport operator. The motivation behind this is clearly to assist BAA's owners, ADI<sup>9</sup>, and its main shareholder,

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<sup>2</sup> Published by County NatWest Ltd on behalf of the Department of Transport, 8 July 1987.

<sup>3</sup> 'The Future of Air Transport in the United Kingdom', DfT, Dec 2003 ('ATWP')

<sup>4</sup> ATWP, para 11.26

<sup>5</sup> DfT, Dec 2006

<sup>6</sup> ATWP Progress Report, para 5.1

<sup>7</sup> Ibid, para 4.10

<sup>8</sup> Ibid, para 4.11

<sup>9</sup> Airport Development and Investment Ltd

Ferrovial<sup>10</sup> in over-coming the difficulties of funding a second runway at Stansted. However, it is questionable whether this would be consistent with the following policy statement in the ATWP:

*"The Government will not promote or pay for the development of Stansted."*

- 8 In any market, competition depends upon there being competing providers of capacity and a degree of excess capacity such that real choices can be made. On both counts, it follows that it would be premature to de-designate Stansted at a time when (i) it remains an integral part of a London airports 'system' operated by BAA alongside Heathrow and Gatwick and (ii) the DfT considers there to be a severe capacity shortage in the south east. Expansion plans exist for Luton and Heathrow airports as well as for Stansted but these, even if implemented, will not materially add to capacity for several years.
- 9 The Competition Commission ('CC') is in the midst of an investigation into the structure of the UK airports market in the south east (and in central Scotland). This investigation will provide evidence, analysis and insights into the workings of the airports market in the south east which will be invaluable in informing the decision on whether Stansted should be de-designated. In addition, the CC investigation may well lead to substantial structural change in the market. Until such time as the CC has reported it would be premature to change the (de)designation criteria and it would be irrational and irresponsible to de-designate Stansted ahead of the CC's report.
- 10 As stated at the start of this letter we support the principle of airport de-designation and one of our main reasons for so doing is that we recognise there could be a very substantial benefit to the Exchequer, i.e. to the taxpayer. Removal of price controls at Stansted would enable the airport operator to increase airport charges and the additional revenues would drop down in full to EBITDA<sup>11</sup>. The value of this can be estimated by looking at the EBITDA multiples paid for airport businesses in recent acquisitions which have been in the range 15x to 20x (some have been much higher)<sup>12</sup> – i.e. an additional £1m of annual EBITDA would add £15m to £20m to the value of the business. The benefit of this added value should primarily accrue to the Exchequer rather than to the owner of the airport.
- 11 We would be interested to know whether the DfT has taken advice on the potential opportunity for the Exchequer arising from airport de-designation and, if so, to see a copy of the advice received. We are concerned that any hasty decision to de-designate Stansted without securing significant financial benefit for the taxpayer would set a precedent and undermine the ability of the Exchequer to secure a price for the future de-designation of Gatwick and Heathrow, where de-designation has a far higher value.

Yours sincerely



Brian Ross  
Economics Adviser

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<sup>10</sup> 62% of ADI is owned by Grupo Ferrovial, S.A.; 28% by Caisse de dépôt et placement du Québec and 10% by GIC Special Investments Pte Limited (Singapore)

<sup>11</sup> Earnings before interest, tax and depreciation.

<sup>12</sup> Budapest (2005) x28; Bratislava (2006) x23; London City (2006) x28.