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17 March 2006

FAO: Ms Susie Talbot Economic Regulation Group CAA 4th Floor, CAA House 45-59 Kingsway London WC2B 6TE

Dear Ms Talbot

Airports Review - Policy Issues

Please find attached our response to the above consultation.

We would draw your attention to our request for confidentiality in relation to the highlighted text in paragraphs 42 and 43 of our response but are otherwise content for the remainder of our response to be published.

In the event of any questions arising, we have included contact details at the end of our response.

Yours sincerely

For Stop Stansted Expansion

Airports Review Policy Issues

Response to CAA Consultation

Stop Stansted Expansion

17 March 2006



Abbreviations

ATM Air Transport Movement

ATWP Air Transport White Paper ("The Future of Air Transport", DfT, 2003)

CP CAA Consultation Paper ("Airports Review - Policy Issues", 2005)

DfT Department for Transport

EERA East of England Regional Assembly

LAQ Local Air Quality

NEMA Nottingham East Midlands Airport

NFC No Frills Carrier

OFT Office of Fair Trading

PATM Passenger Air Transport Movement

RAB Regulated Asset Base

RSS Regional Spatial Strategy

SERAS South East Region Air Studies

SRA Strategic Rail Authority

SSE Stop Stansted Expansion

Stansted ACC Stansted Airlines Consultative Committee

STACC Stansted Airport Consultative Committee

Q5 Fifth Quinquennial Review Period (1 April 2008 – 31 March 2013)

WACC Weighted Average Cost of Capital

WAML West Anglia Main Line

Introduction

- 1. Stop Stansted Expansion ("SSE") welcomes the opportunity to comment on the CAA 'Airports Review Policy Issues' consultation paper ("the CP") which describes the approach that the CAA is minded to adopt in relation to setting price controls for the next (Q5) quinquennial review of charges for designated airports.
- 2. SSE was formed in August 2002 following the publication of the Department for Transport ("DfT") consultation paper, 'The Future Development of Air Transport in the United Kingdom'. SSE now has some 6,000 members and the support of more than 100 organisations including local councils, residents' groups and environmental organisations.
- 3. We recognise that the CAA's regulatory role is circumscribed by its four statutory duties set down in Section 39 of the Airports Act, 1986 and that these do not embrace environmental considerations. We regret the narrowness of the current regulatory framework and would argue that the CAA should have regard to environmental considerations, global and local. However, we are content to make this submission on the basis of the extant statutory framework and the market arguments.
- 4. Our attached response is evidence-based and we hope will assist the CAA in the conduct of the Q5 regulatory review. Our points are grouped under the following headings:
 - A. Market demand
 - B. Planning and financial viability considerations
 - C. Regulatory principles
 - D. BAA's market dominance
- 5. Our main contention throughout this response is that it would at best be premature for the CAA to encourage the development of a second runway during Q5 when the evidence suggests that this will not be needed before Q7 and even then, only if demand materialises. Moreover, we believe that premature development of a second runway at Stansted would be discriminatory and distortionary as regards other airports in the south east, and indeed beyond.

A. Market demand

6. In para 3.54 of the CP, the CAA notes that the Air Transport White Paper¹ ("ATWP") was "based on evidence then available and the Government's own analysis of it (using different criteria from those contained in the Airports Act 1986)." In our view, the Government's analysis of the evidence available to it prior to the ATWP was seriously flawed but, leaving that point aside and focusing upon the evidence now available, SSE draws attention to the following factors which indicate a substantial change in the landscape since the publication of the ATWP:

Slowdown in growth at Stansted

7. In the five years leading up to publication of the ATWP, Stansted experienced annual passenger growth averaging 25% and annual air transport movement ("ATM") growth averaging 13%. There has however been a marked slowdown in Stansted's growth rate

¹ 'The Future of Air Transport', DfT, December 2003

since 2003 with year-on-year passenger growth now down to around 5% and ATM growth now below 1%.

Stansted growth rate	<u>2003</u>	<u>2004</u>	<u>2005</u>
MPPA growth	17%	12%	5%
ATM growth	11%	4%	1%

Source: BAA Traffic Statistics

- 8. BAA's July 2005 consultation document² relating to expanded use of the existing Stansted runway, provides a 2015 forecast of 274,000 movements on the existing runway compared to 193,500 movements in 2005. This document also states that 274,000 movements would represent 87% of the theoretical maximum capacity of the existing runway based on 48 movements an hour during the day (17.5 hours) and no change in the current limit on the number of night flights.
- 9. Taking passenger air transport movements ("PATMs") alone, the comparison is between a 2005 baseline of 166,800 and a BAA forecast of 243,000 by 2015, i.e. a 46% increase by 2015 with further potential capacity available beyond that. It is therefore difficult to understand the urgency for a second runway at Stansted in the context of a 1% annual ATM growth rate. Extrapolation is of course an over-simplistic way of looking at this and we recognise that recent/ongoing fleet replacement by Ryanair and Easyjet (which together account for 87% of Stansted's passengers) has dampened ATM growth in a way that may not be sustained. We note however that the uplift in average aircraft capacity projected by BAA in formulating its forecasts is relatively modest from 132 passengers per PATM in 2005 to 144 passengers per PATM in 2015.
- 10. With regard to passenger capacity, we note that whilst BAA normally indicates a capacity of "about 35 mppa" for the existing Stansted runway, it has stated on the record³ that it believes 40 mppa to be achievable. Our own view is that even this is slightly conservative and that Stansted could be capable of handling approximately twice its current throughput of 22 mppa on the existing runway, *if such demand were to materialise*.
- 11. Taking Stansted in isolation, the evidence strongly suggests that there will be insufficient market demand to support the development of a second Stansted runway during Q5 or even Q6. Regarding the wider market, we have seen no evidence to support the DfT's 'spillover' theory whereby unsatisfied Heathrow demand would transfer to Stansted a theory which we believe fails to recognise the fundamental differences in the characteristics of the two airports. We therefore consider that it is unnecessary and would be wholly inappropriate for the CAA to incentivise BAA to initiate the development of a second Stansted runway during Q5.

Growing importance of regional airports

12. The traffic characteristics of Stansted have far more in common with regional airports than with Heathrow, namely a focus on short haul leisure travel, increasingly at a budget price; and the market trend towards the regionalisation of air travel – significantly underestimated at the time of the ATWP – is a factor which is dampening demand growth at Stansted and, we believe, will continue to do so for the foreseeable future.

³ For example: minutes of Stansted Airport Consultative Committee, Jan 2006

² 'Growing Stansted Airport on the Existing Runway', BAA, July 2005

- 13. CAA airport traffic statistics for the year 2000 baseline used in the ATWP, show that airports in the south east (including London) and the east of England (hereafter jointly referred to as "the south east") were at that time handling 65% of all UK air travel⁴. The Government acknowledged that this represented an over-concentration upon the south east, which accounts for only about one third of the UK population, whilst noting that residents of the south east have a greater propensity to fly than residents of other regions (although this is a function of supply as well as demand). The ATWP supported some redistribution of air travel towards the regions and projected a 60:40 split by 2030⁵ from the baseline of 65:35 in 2000.
- 14. The experience since publication of the ATWP is that the level of redistribution to regional airports projected by the DfT to happen by 2030 has already been surpassed. In 2005, airports in the south east accounted for 59.6% of all air travel and regional airports for 40.4%. Over the past five years, airports in the south east have grown passenger numbers by 16% whereas regional airports have grown passenger numbers by 46%.⁶

Passengers (million)	2000	<u>2001</u>	2002	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>Growth</u> 2005 vs 2000
South east airports	117	115	118	122	131	136	16.2%
Regional airports	63	67	71	78	85	92	46.4%
Regional share	34.9%	36.9%	37.8%	39.1%	39.4%	40.4%	

Source: CAA airport statistics

- 15. This redistribution has not come about as a consequence of capacity constraints in the south east but rather, we would contend, reflects the evolution of the no-frills carrier ("NFC") sector. Having initially established itself and proved viability on routes from bases in the south east, the NFCs are now able to interrogate their customer databases as the market expands and identify viable opportunities for direct routes from regional airports. In addition, we are increasingly seeing the emergence of regionally-based NFCs. We see no reason why this trend should not continue so that regional airports might reasonably be expected to be handling 50% of all UK air passenger traffic by around 2020.
- 16. This has significant implications for the need for any second runway at Stansted, at least within the timescale presently envisaged. Para 5.9 of the CP highlights the issue: "For every three passengers originating from the East Midlands area that use NEMA [Nottingham East Midlands Airport], one travels from the East Midlands area to use Stansted." The footnote to para 5.9 then points out that in relation to scheduled flights, for every two passengers originating from the East Midlands area that use NEMA, one travels from the East Midlands area to use Stansted.
- 17. The source for this information is the 2004 CAA Passenger Survey Report and we would respectfully suggest that the reported data might not in any event tell the complete story. For example, the data suggest that in 2004 Stansted attracted more passengers from

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⁴ 'The Future Development of Air Transport in the United Kingdom: South East', 2nd Ed., DfT, Feb 2003

⁵ ATWP, Annex A, para 18

⁶ CAA Airport Statistics for 2000-2005 (2005 provisional)

the Isle of Wight than from the North East, the North West, Scotland, Wales and the South West - all combined.⁷ Based on anecdotal evidence we suspect that the format of the questionnaire and its usage by the CAA interviewers may result in Stansted passengers from far afield who have stayed overnight locally (or relatively locally) prior to their flights not always being correctly classified as to their origin.

- 18. Notwithstanding these reservations, the statistics even as they stand indicate that Stansted imports a significant proportion of its passengers from quite far afield and so competition issues arise in relation to overlapping catchment areas. This bears directly on the appropriateness of the regulator supporting an additional runway at Stansted in the timescale currently envisaged. It is worth also pointing out that the availability of regional airport capacity, possibly on more favourable terms, will be an influencing factor in the minds of Ryanair, Easyjet and other existing Stansted airline customers when they are deciding their own future development plans.
- 19. In a similar vein, albeit within the south east region, the possibility of NFC development at smaller airports such as Lydd, Manston, Southend, Cambridge etc should not be overlooked. The way in which the NFC sector has developed over the past ten years has brought many surprises and doubtless there will be more surprises to come.

Luton development

- 20. The announcement of plans for a new (replacement) runway and associated terminal facilities at nearby Luton Airport by mid-2012 has a significant bearing on the potential demand for any second runway at Stansted, at least within the timescale presently envisaged. In addition, the Luton development will exacerbate the funding difficulties for a second runway at Stansted. Luton expects to expand to 30 mppa by 2020 (considerably faster than was projected in the ATWP) and there is considerable overlap in the geographical catchment areas of the two airports, as evidenced in the maps provided at figures C-7 and C-8 of the CP. In addition, Luton's target market budget short-haul leisure travel is the same as for Stansted.
- 21. In an internal ministerial briefing note just prior to publication of the ATWP, the DfT acknowledged the potential for additional capacity at Luton to undermine the financial case for an additional runway at Stansted at around the same time: "...the market appetite for an additional Stansted runway would be affected if material additional capacity at Luton is coming on stream at the same time." ⁸ It is reasonable to deduce that the converse also applies, i.e. a second runway at Stansted coming on stream at around the same time as new capacity at Luton would have an adverse effect upon the commercial performance of Luton and could potentially force a re-think by the operator of Luton as regards the scale and/or timing of the development.
- 22. The competition implications are obvious and it is incumbent upon the CAA to ensure that it does not encourage or facilitate the provision of additional capacity at Stansted in such a way as would be "distortionary or discriminatory as regards other airports in the south east." In this context, the suggestion by BAA of a 'public interest levy' of perhaps 50p or £1.00 per passenger on users of Heathrow and Gatwick airports to help fund expansion of Stansted would be both distortionary and discriminatory. As we understand it, BAA is not proposing that the proceeds from this 'public interest levy' could also be used to fund the expansion of Luton. The idea of a public interest levy appears to be nothing less than an attempt to circumvent the principle of stand-alone regulation and revert to a form of system

⁷ 'Annual Passenger Survey Report, 2004', CAA, 2005, Tables 7.5 and 8.5

⁸ 'Funding the First Runway Development at an Airport in the South East of England', DfT, Nov 2003, Executive Summary, p3

funding. We note with some concern that a recent CAA presentation to the aviation industry referred to the possibility of inter-airport funding in a more "open-minded" way than is set down in the CP.

23. Returning to the question of capacity versus demand, our key contention is that it would, at best, be premature for the CAA to encourage the development of a second Stansted runway during Q5. Capacity constraints are unlikely to 'bite' until Q7 (2018-2023) and it would distort the market and be to the detriment of Stansted's competitors if a second runway were to be provided prematurely, in much the same way as happened in the early 1990s in relation to Stansted and Luton. With ample warning, including the regulator's own analysis as presented to the DfT and HM Treasury during the ATWP preparation stage¹⁰, it would be extremely difficult for the regulator to justify allowing history to repeat itself.

Heathrow expansion

- 24. It is not SSE's policy to advocate expansion of Heathrow as opposed to Stansted. Indeed, we believe that a third Heathrow runway would be wholly unacceptable from an environmental standpoint and even the introduction of mixed mode operations at Heathrow would have a highly adverse effect upon the quality of life for those living nearby. In this submission however we are required to address ourselves to the statutory framework by which the Regulator is bound and in this section of our response we are addressing the changing landscape since the publication of the ATWP. We therefore cannot avoid commenting upon the prospects for Heathrow expansion because, notwithstanding the very different traffic characteristics of the two airports, this has been perceived by some parties, including the DfT, to have an important bearing upon development at Stansted.
- 25. The ATWP gave support to a third Heathrow runway from as early as 2015 and that subject to further consultation there should be full use of the existing runway capacity at Heathrow (i.e. mixed mode), both dependent upon stringent environmental conditions being met including, crucially, the requirement to ensure compliance with the EU Air Quality Framework Directive (EU 99/30/EC). Consultation on mixed mode will commence shortly and towards the end of 2006 or early in 2007 the Government is expected to announce its decision on mixed mode as well as reporting on the progress made in addressing the Heathrow local air quality ("LAQ") problem and providing a revised assessment of the prospects for, and likely timing of, any third Heathrow runway.
- 26. The regulator will need to form a view on the likelihood and timing of any increase in capacity at Heathrow and the bearing this will have upon the demand for and financial viability of a second runway at Stansted. The internal DfT briefing note referred to earlier concluded that additional capacity at Heathrow could undermine the fundability of an additional runway at Stansted: "It would be difficult, however, to fund an additional runway at Stansted opening in 2012, followed by an additional runway at Heathrow, opening soon after, say 2015. It would be better in funding terms if that Heathrow runway opening was delayed until 2020." ¹¹ It is already clear from BAA's own statements that it cannot meet a 2012 delivery date whatever the funding arrangements. ¹²

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⁹ CAA Industry Seminar, 16 Jan 2006, Slide 19

¹⁰ Notably, 'Airport Expansion in the South East', CAA, Dec 2003

¹¹ 'Funding the First Runway Development at an Airport in the South East of England', DfT, Nov 2003, Executive Summary, p4

¹² For example: "If the planning system works as it's supposed to, and our regulator agrees a satisfactory pricing formula to remunerate our shareholders, the first phase of Stansted G2 can be operational by the end of 2013." Mike Clasper, BAA plc CEO, 9 December 2005

- 27. It is important to note that the above internal DfT briefing note did not consider the introduction of mixed mode at Heathrow prior to any additional runways at Heathrow or Stansted. If approved, mixed mode could provide an estimated minimum of 15 mppa additional capacity at Heathrow well in advance of 2015. For those who support the 'spillover theory', the logical implication is that this would reduce/delay the demand for a second Stansted runway.
- 28. The ATWP expresses Government support for a second runway at Stansted as the *first* new runway in the south east i.e. in advance of any new runway at Heathrow (or at Gatwick, in the event that Heathrow LAQ problems cannot be resolved). However, as has often been said by the Secretary of State for Transport, "Governments do not build runways", and the ATWP includes the undertaking that "The Government will not promote or pay for the development of Stansted." ¹³
- 29. We support the CAA's interpretation (CP 3.52 CP 3.55) of the relationship between its statutory duties and the objectives set down in the ATWP, namely that the former take precedence. The regulator will need to take an independent view as to whether Stansted should be the first new runway development in the south east. The CAA's statutory duty under Section 39 of the Airports Act, 1986 as to timeliness in satisfying user demand, as well as those duties relating to airport efficiency and profitability will be important considerations alongside the market dynamics, the prospect of financial viability, the ability to secure the necessary funding and the cost of that funding. All of these considerations, when weighed, may result in the regulator reaching a different conclusion from that reached by the Government in the ATWP as regards the sequence of runway development in the south east.

Capacity vs demand in the south east.

- 30. With a new runway at Luton and full use of the existing Stansted runway, there would be combined capacity of about 70 mppa at these two airports by 2020. Heathrow will have capacity of about 90 mppa by 2020 even without an additional runway, rising to 105 mppa if mixed mode were to be permitted. Gatwick will have about 40 mppa capacity by 2020 and other airports in the south east (Southampton, London City, Norwich etc) might reasonably be expected to provide 10 mppa capacity by that time giving total south east capacity of around 210 mppa 225 mppa by 2020¹⁴. This would be capable of meeting between 54% and 58% of total projected UK demand in 2020, depending on whether mixed mode is introduced at Heathrow.
- 31. In paras 12-15 above we set down the analysis behind our assertion that regional airports are likely to account for 50% of the UK market by 2020 and so if the south east can accommodate 54% and 58% if mixed mode at Heathrow without an additional runway¹⁵, there would appear to be rather less urgency for a new runway in the south east than was envisaged at the time of the ATWP. It should also be noted that past estimates of airport capacity have always proved to be conservative.
- 32. One could also argue and indeed the DfT 'SPASM' forecasting model would suggest¹⁶ that with the trebling of the oil price since the DfT forecasts were last updated and mounting pressure for aviation to bear its environmental costs, future demand growth in UK air travel will be less than envisaged at the time of publication of the ATWP.

¹⁴ Rounded statistics taken from DfT forecasts and relevant airport master plans

¹³ ATWP, highlighted box beneath para 11.41, p118

¹⁵ Luton is assumed to be a replacement rather than an additional runway

¹⁶ In February 2003 the DfT ran a number of sensitivity tests on its SPASM air traffic forecasting model. The results are reported in 'The Hidden Cost of Flying', AEF, p18

33. Specifically, in relation to Stansted, we contend that it would - at best - be premature for the CAA to encourage the development of a second runway during Q5 when the evidence suggests that this will not be needed before Q7 and even then, only if demand materialises. Moreover, we believe that premature development of a second runway at Stansted would be discriminatory and distortionary as regards other airports in the south east, and indeed beyond.

B. Planning and financial viability considerations

Despite the ATWP's support for a second Stansted runway, we believe that the obstacles are such that the airport operator will not be able to proceed with the project in Q5 or indeed Q6; the position beyond that time depends on a number of unknowns. BAA has already made clear that it cannot meet the 2011/12 timetable set down in the ATWP, indicating that the earliest delivery date would be the end of 2013 and this only if a system basis for regulation (or any other form of cross-subsidy under another name) were to be reintroduced in Q5. Without the reintroduction of a system approach to funding, BAA has stated that there would be a further delay of "several" years. ¹⁷ But in our view the problems are more fundamental than that.

Financial viability

First, it is worth recapping on what BAA said in its formal response to the DfT consultation on 'The Future Development of Air Transport in the United Kingdom':

"We currently believe that the option for one new runway at Stansted would be financially viable, subject to the scale of the additional costs not calculated in SERAS, but the charges needed to remunerate the investment would need to be shared across users of the London system as a whole rather than applied to Stansted users only." 18

"In BAA's view, the DfT's 12.5% pre-tax level of return may not be high enough to remunerate investment in a new runway, given the significant funding requirements that it would generate." 19

- 36. There have been some changes in circumstances since 2003: BAA now estimates (mistakenly in our view) that the cost of a second Stansted runway would be significantly less than the SERAS estimate; the cost of long term corporate borrowing has reduced dramatically; and (largely as a result of this) higher levels of gearing have become not only more acceptable to the financial markets, but almost essential.
- Set against these favourable changes, however, Stansted's growth rate has slowed markedly, there has been a market trend towards regional airports; and there is the prospect of more alternative capacity coming on stream sooner than anticipated in 2003. In addition, the price of oil has trebled and, although this so far appears to have had little effect upon the NFCs, the footloose and parsimonious nature of Stansted's narrow customer base continues to present a particular challenge.

^{17 &}quot;... the delay from pure stand-alone as opposed to the kind of system-wide contribution we're talking about is several years." Mike Toms, BAA Planning & Regulatory Affairs Director, Stansted Planning Update, 18 May 2005

¹⁸ 'Responsible Growth', BAA, May 2003, para 7.51

¹⁹ Ibid, para 9.32

- BAA has repeatedly stated (quite rightly) that the company will not proceed with a 38. second runway at Stansted unless it is in the interests of its shareholders to do so.²⁰ BAA has also stated that a decision on a second Stansted runway will not be taken until around the end of 2008²¹ and will be dependent upon both of the final outcomes of the Q5 regulatory settlement and the planning application, which BAA expects to be known by that time. 22 BAA may then require to seek shareholder approval for the project.
- Leaving aside the issue of shareholder approval, in our view, BAA's assessment of the timescale for taking forward the project is highly optimistic. Originally, this was based on a planning inquiry starting, finishing and sending its decision to the Secretary of State all during 2007. 23 However, BAA now believes that a planning inquiry could not commence until 2008.24
- Turning to the question of cost, in December 2005 BAA published a cost estimate of 40. £2.7bn, excluding surface access costs, for a second Stansted runway²⁵. This is significantly less than the original SERAS estimate of £3.2bn, excluding surface access costs, at 2000 prices. (SERAS estimated surface access costs would be £800m in total, not all of which would require to be paid for by BAA.) We accept that BAA can achieve substantial cost savings by now planning for a 'cheap and cheerful' facility more suited to its role as an NFC operating base rather than as the international hub airport which SERAS envisaged. We are however surprised at the scale of cost reduction which BAA anticipates and particularly by its view that the first phase can be delivered for £1.7bn.
- In the analysis it carried out for the DfT and HM Treasury in 2003²⁶ the CAA pointed 41. out that Heathrow T5 costs, excluding surface access, equated to £103m per incremental mppa whereas SERAS had assumed 'only' £40m per incremental mppa for the terminal component of capital expenditure at Stansted. We interpreted this comparison as an implied concern by the CAA that SERAS may have underestimated Stansted development costs, at least in respect of new terminal capacity. We therefore draw the CAA's attention to the fact that the terminal component of capital expenditure for BAA's preferred option A, as set down in its December 2005 consultation document, is very substantially less than the SERAS estimate. We are pleased to note (CP 8.31) that the CAA intends to examine BAA's capital cost estimates and to review the evidence available from BAA and others in relation to surface access investments.
- 42. We believe that BAA has substantially underestimated the cost of developing a second Stansted runway. We are not qualified to question the construction costs of the main airport facilities but below, we set out three important other areas where, in our view, BAA has seriously misjudged the scale of investment that will be required.
- (i) Surface access costs;
- (ii) Costs associated with environmental mitigation;

²⁰ For example: "Let me be quite clear. BAA will not ask its shareholders and lenders to support any project for which there is no sound business case." Mike Clasper, BAA plc CEO, 18 May 2004 ²¹ For example: 'Stansted Generation 2 Forecast Expenditure Report' BAA, Sep 2004, para 7

²² In our view, a planning decision is unlikely before 2009 at the earliest

²³ 'Stansted Generation ² Forecast Expenditure Report' BAA, Sep 2004, para 7

²⁴ 'Stansted Generation 2: December 2005 Consultation', BAA, Dec 2005, Ch 1, p6

²⁵ Ibid, Table 11, p40

²⁶ 'Airport Expansion in the South East' (Final Funding Paper), CAA, Dec 2003, p62

SHADED SECTION TO BE TREATED AS 'CAA – IN CONFIDENCE'

Planning issues - general

- 44. The CAA has stated that, whilst its statutory duties take precedence, it must take account of Government policy as set down in the ATWP insofar as this will influence the likelihood of planning consent for any new runway developments. It will however be important for the CAA to have regard to the totality of the ATWP and not merely to its top-line conclusions because the "balanced and measured" totality of the ATWP will influence the conditions attaching to any planning consent which, in turn, will influence the financial viability of the development.
- 45. It is reasonable to anticipate that planning consent for a second Stansted runway will continue to be robustly opposed at local level. The East of England Regional Assembly ("EERA") is opposed to a second Stansted runway and has excluded any provision for this in its Draft Regional Spatial Strategy ("RSS")²⁷ which, when finalised, will become the context for any future planning application. It remains to be seen whether the Government will attempt to over-rule the Region in this regard and, if so, whether this would give rise to a legal challenge. The five local authorities most directly affected by Stansted development (Essex and Hertfordshire County Councils and Uttlesford, East Hertfordshire and North Hertfordshire District Councils) have already demonstrated their willingness to use legal avenues to challenge the Government on this issue and their determination to continue to oppose a second Stansted runway at every turn should not be underestimated. It is also worth noting that the independent 'Sustainability Appraisal' of the Draft RSS, commissioned by EERA, challenged the Plan's support for airport expansion even up to the maximum use of the existing runways and for failing "... to grasp the point that further growth in air travel provision is environmentally unsustainable." 28
- 46. If a planning application were to be submitted by the airport operator, a public inquiry would be inevitable and the inspector would need to have regard to the "balanced and measured" totality of the ATWP. The inspector would also require to have regard to other, wider Government policy statements; to the analysis and conclusions of the last Stansted public inquiry, for example, that expansion beyond a single runway would be "a catastrophe in environmental terms" and ""an unprecedented and wholly unacceptable major environmental and visual disaster" ²⁹; and to the statutory duties of local authorities, for example, to "... exercise the [planning] function with the objective of contributing to the achievement of sustainable development" ³⁰. Contradictions would inevitably emerge and a

²⁷ 'East of England Plan' (Draft RSS), EERA, December 2004, para 2.24, p9

²⁸ 'East of England Plan: Sustainability Appraisal', Levett-Therivel on behalf of EERA, Nov 2004, p283

²⁹ 'The Airports Inquiries 1981-1983', Report of Inspector Graham Eyre QC, 1984, Ch 25

³⁰ Planning and Compulsory Purchase Act', 2004, Section 39(2)

recommendation for planning approval would by no means be a foregone conclusion. Even if permission for a second Stansted runway were to be recommended, the conditions attaching to this might well result in this being a pyrrhic victory for the airport operator.

Environmental mitigation

47. In the absence of an Environmental Impact Assessment (which is not expected to be available until the middle of 2007 at the earliest) BAA is 'flying blind' with regard to the costs of environmental mitigation and indeed whether there is a prospect of being able to mitigate the environmental impacts of a second runway at Stansted. And, in addition to the statutory framework, the ATWP set down the following policy framework for airport development:

"Local controls should operate within these principles to manage the environmental impact of aviation and airport development so that:

- noise impacts are limited, and where possible reduced over time;
- local air quality is maintained within legal limits across all relevant pollutants in order to protect human health and the wider environment;
- loss of landscape and built heritage is avoided wherever possible, and otherwise minimised and mitigated to the greatest extent possible;
- all relevant water quality and other mandatory environmental standards are met:
- surface access to airports is designed to help limit local environmental impacts; and
- impacts on biodiversity, such as disturbance of habitats and species, are minimised " 31
- 48. Looking at just three of the above conditions for development 'loss of landscape and built heritage [to be] avoided wherever possible...'; 'surface access to airports [to be] designed to help limit local environmental impacts'; and 'impacts on biodiversity, such as disturbance of habitats and species, [to be] minimised' the CAA will quickly see the potential for major cost implications which are clearly not reflected in BAA's cost estimates for a second Stansted runway. In the event of a planning application being submitted, the interpretation and judgement of these conditions will be down to the inspector at public inquiry. An inspector would appear to have only limited room for manoeuvre in this area, especially since the ATWP emphasis upon stringent environmental conditions is reinforced by a number of other clearly stated transport and environmental policies set down in other equally relevant Government policy statements including other White Papers.

Surface access

49. As in the case of the environmental issues, we highlight the surface access issues in this response, not because we expect the CAA to directly involve itself in these matters but, rather, because they will – as the CAA recognises in CP 26 – influence the planning environment, development costs and financial viability of developing a second Stansted runway. It is therefore important for the CAA to be well informed on Stansted surface access issues insofar as they have a significant bearing on the prospects for a second Stansted runway being developed during Q5.

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³¹ ATWP, para 3.6, p30

- Surface access is an acute problem in relation to any further expansion of Stansted Airport and has been described as Stansted's Achilles heel. Restricted capacity on the West Anglia Main Line ("WAML") into Liverpool Street has already resulted in services to local users being cut back in order to accommodate four Stansted Express trains an hour in each direction and additional stops have recently been introduced on the Stansted Express in an attempt to pacify local users, whilst having the effect of lengthening journey times to the airport and exacerbating overcrowding at peak hours. The need for major investment to increase the capacity of the WAML into Liverpool Street is patently obvious to any regular user of the service and yet BAA's proposals for making greater use of the existing runway do not include any further investment in rail infrastructure.
- 51. It is inconceivable that a second runway could be developed without very substantial investment in this area. SERAS estimated that a second Stansted runway would entail rail investment of £716m (at 2000 prices) based only on providing (a) passing loops between Harlow and Tottenham Hale on the WAML; (b) a second rail tunnel into the airport; and (c) a second airport station. A further £625m was estimated as the cost of providing 3-4 tracks (vs 2 current) between Stansted and Tottenham Hale.³³
- The SERAS estimates were based on Stansted being developed as an international hub with about 35% of passengers being interliners and therefore not requiring surface access transport. However, the ATWP concluded that Stansted should develop along much the same lines as at present, i.e. focused on NFCs operating point-to-point short haul services. As such, the proportion of interliners is likely to remain similar to the present 13%³⁴ and this has significant implications upon the demand for surface access.
- A comparison with Heathrow is a useful way of demonstrating the scale of the surface 53. access challenge at Stansted. Out of 67m passengers handled by Heathrow in 2004, 35% were interliners, leaving 44m Heathrow passengers requiring surface access.³⁵ Almost exactly the same demand would arise at Stansted if handling 50 mppa. And one should bear in mind that Heathrow is served by London Underground as well as by the Heathrow Express, the latter having a reasonably reliable 15 minute journey time from central London compared to an unreliable 50 minutes from Liverpool Street to Stansted.
- If Stansted were handling 76m passengers a year³⁶, 66m would require surface access to/from the airport, compared to 18m in 2004. The additional demand on the surface access infrastructure serving Stansted would equate to almost a million extra journeys to and from the airport every week (excluding airport employees). Even with no increase in the proportion travelling to/from the airport by train, the rail network would be expected to handle 22m Stansted passengers a year. For comparison, Heathrow Express and London Underground, together, transported just under 10m passengers to and from Heathrow in 2004, in roughly equal proportions. ³⁷
- The pre-ATWP ministerial briefing note³⁸ referred to earlier includes an estimate by the Strategic Rail Authority ("SRA") of £1bn for the cost of rail infrastructure to support a second runway at Stansted and an assumption that BAA would require to fund 50% of this. It is not clear what this estimate was based upon or how it was arrived at. However, a

³² 'Growing Stansted Airport on the Existing Runway', BAA, July 2005

³³ 'SERAS Stage Two Appraisal Findings Report', DTLR, April 2002, Tables 9.3 and 9.13

³⁴ 'Annual Passenger Survey Report, 2004', CAA, 2005

³⁶ 'Stansted Generation 2: December 2005 Consultation', BAA, Dec 2005, Table 11, p40

³⁷ 'Annual Passenger Survey Report, 2004', CAA, 2005

³⁸ 'Funding the First Runway Development at an Airport in the South East of England', DfT, Nov 2003

consultation on Stansted surface access issues is expected to commence within the next few months. It should be noted that any major surface access infrastructure project would have its own environmental impacts and might itself be the subject of public inquiry.

- 56. Turning to roads, BAA stated in 2001 that if a second runway were to be developed at Stansted, taking its capacity to 67 mppa (rather than the 76m now proposed by BAA), the M11 would need to be widened from dual-3 carriageway to dual-5 carriageway standard between junctions 6 and 8 (a distance of 14 miles): "Upgrading the M11 to dual-5 lane carriageway to the south of the airport to the M25 would be required. In addition, major new regional access arrangements would need to be determined." ³⁹
- 57. In more recent statements, however, BAA has been more circumspect, which may or may not be connected to the policy set out in the ATWP, namely: "The Government expects developers to pay the costs of upgrading or enhancing road, rail or other transport networks or services where these are needed to cope with additional passengers travelling to and from expanded or growing airports." ⁴⁰
- 58. The DfT ministerial briefing note previously referred to⁴¹ concluded that "The addition of a runway would, without area wide action to improve the performance of the network, require widening [of the M11] to dual-4 standard by 2015." However, the briefing note provides no estimate either of the total cost or of the cost that would need to be borne by BAA for this or any other road improvements which would be needed to support an expanded airport.
- 59. It beggars belief that, following the publication of the ATWP in December 2003, which supported the development of a second Stansted runway "as soon as possible", both the DfT and BAA have been completely silent on the issue of providing the surface access infrastructure to support Stansted development. Even complex planning inquiries can sometimes move faster than that. Strictly speaking, the silence has been interrupted on one occasion, namely, the recent DfT announcement of a 10-15 year postponement of the proposed widening of the M11 to dual-3 carriageway between junctions 8 and 9 (from Stansted Airport north to the A11).⁴²
- 60. Lead times for the development of road and rail infrastructure projects are notoriously lengthy and yet, within the next two months, BAA is expected to submit a planning application for substantial expansion on the existing runway beyond its present planning limit of 25 mppa. We will not be surprised if this application contains the claim that no new investment is needed in surface access infrastructure but we very much doubt that the planning authority will be convinced by this.
- 61. The ATWP called upon airport operators to submit airport masterplans, to include surface access implications, by the end of 2004. BAA's first response to this was its draft interim masterplan published in July 2005 which dealt only with expansion on the existing runway and contained no proposals for investment in surface access infrastructure. Moreover, BAA envisaged no increase in the current public transport mode share of 40% in the period to 2015⁴⁴ and said nothing about increasing public transport mode share beyond that time. The avoidance of investment in rail infrastructure may be consistent with

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³⁹ 'A Regional Air Services Study for the South East and East of England - Report on Behalf of the DETR', BAA, April 2001, para 6.11.10, p54

⁴⁰ ATWP, para 4.58,p60

⁴¹ 'Funding the First Runway Development at an Airport in the South East of England', DfT, Nov 2003

⁴² DfT letter to EERA, 23 November 2005

⁴³ ATWP, paras 12.8 and 12.9, p141

⁴⁴ 'Growing Stansted Airport on the Existing Runway', BAA, July 2005

minimising airport expansion costs (and maximise car parking revenues) but this is directly at odds with the Government's wider surface transport policies, to which we now turn.

In a planning context, other Government White Papers are equally important as the ATWP. The 1998 Transport White Paper, for example, is likely to have a significant bearing on Stansted Airport development issues. The following extracts give a flavour of its policy thrust:

"There is now a consensus for radical change in transport policy. The previous Government's green paper paved the way with recognition that we needed to improve public transport and reduce dependence on the car." 45

"We want to preserve and enhance our environment: the places where we live and work, our built and natural heritage and our richly diverse countryside." 46

"We envisage that local authorities, including the Passenger Transport Authority where applicable, would participate in the Airport Transport Forum which should ... draw up and agree challenging short and long term targets for increasing the proportion of journeys to the airport made by public transport ..." 47

- At present, 60% of Stansted passengers travel to the airport by car, 11% by bus/coach and 29% by rail.⁴⁸ Whilst BAA would claim that a 40% public transport mode share is high by current UK standards (for example, Heathrow achieves only 36%49) we would contend that, even for its present passenger throughput, Stansted's public transport mode share could and should be very substantially increased. The predominance of budget leisure passengers and its distance from London makes rail a particularly attractive option for journeys to and from Stansted. In any event, as part of the "radical change in transport policy" that is called for, dependence on car use needs to be radically reduced at Stansted.
- Ultimately, assuming a planning application for a second Stansted runway is submitted, a public inquiry will consider these matters and surface access infrastructure will be an extremely hard fought issue. All the relevant local authorities have already made their position clear with regard to the need for a radical reduction in car use to the airport and for substantial investment to improve the rail infrastructure. Even if planning approval were to be granted, we believe that this would only ever be on the basis of prior provision of the requisite surface access infrastructure and we would doubt that the cost contribution required from BAA would be any less than £1bn, mostly frontloaded.
- Summarising the cost impact of the three points we set down in para 42 above, we believe that the cost to BAA of developing a second Stansted runway is likely to be between £4bn and £5bn compared to the £2.7bn estimate (excluding surface access costs) that BAA published in December 2005.⁵⁰ We are unable to provide a more accurate estimate at this stage because of the planning uncertainties and pending the outcome of our point (iii) in para 42 but we note that the mid-point of our estimate is broadly similar to the original DfT SERAS estimate, adjusted for inflation.⁵¹

⁴⁵ 'A New Deal for Transport: Better for Everyone', DfT, 1998, Foreword, para 1

⁴⁶ 'A New Deal for Transport: Better for Everyone', DfT, 1998, Ch 1, p11

⁴⁷ Ibid, Ch 3, p72

⁴⁸ 'Annual Passenger Survey Report, 2004', CAA, 2005

⁵⁰ 'Stansted Generation 2: December 2005 Consultation', BAA, Dec 2005, Table 11, p40

⁵¹ 'SERAS Stage Two Appraisal Findings Report', DTLR, April 2002, Tables 9.3 and 9.13

Revenue impact

- 66. A modal shift from road to rail has implications for Stansted's revenue stream because this will reduce income from airport car parking. Stansted presently has 26,750 public car parking spaces⁵² and earned an estimated £32m⁵³ from car parking in 2004/05 equivalent to about £1.50 per passenger and to some 70% of Stansted's operating profit. BAA's December 2005 consultation document⁵⁴ states that Stansted would need 106,000 car parking spaces for 76mppa. This includes staff car parking which we believe would account for about 10% of the total. As a comparison, Heathrow is limited to 42,000 car parking spaces (including staff parking) a restriction imposed following the Terminal 5 public inquiry.⁵⁵
- 67. If a similar type of restriction were to be applied at Stansted, BAA would only be permitted about half of the 106,000 car parking spaces it has suggested and this would result in a significant reduction in its projected car parking revenues. The effect of this, under the single till approach to regulation, would be a significant increase in aeronautical charges. We respectfully suggest that as part of the series of proposed studies which the CAA intends to undertake (CP 8.31 CP 8.40) the impact of a planning restriction on airport car parking at Stansted should be modelled and its potential effect upon aeronautical charges and, thereby, market demand from airlines considered.

Potential operating cost impacts

68. Finally, in this section, it should be noted that Essex County Council is giving consideration to an airport access levy⁵⁶ in respect of road journeys to Stansted Airport as a means of discouraging car traffic. In addition, it is understood that, for the same reason, the introduction of workplace parking charges at Stansted Airport is also under consideration for the longer term. The potential impacts of these measures, in terms of cost and discouraging car use, has not yet been assessed.

C. Regulatory Principles

Stand-alone regulation

69. SSE welcomes the confirmation (CP 5.22) that the CAA proposes to maintain its previously announced position regarding stand-alone regulation of BAA's designated airports. SSE further supports the CAA's views regarding the applicability of EU and UK competition legislation to BAA's activities, and the legal risk to which both BAA and the CAA would be exposed should the CAA adopt (CP 3.40 and 5.14) a form of price control that does not comply in every respect with all legal requirements.

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⁵² 'Growing Stansted Airport on the Existing Runway', BAA, July 2005, Table 7, p14

⁵³ SSE estimate derived by cross-referencing a number of sources including BAA plc financial accounts for 2004/05; analysts' presentations (e.g. May 2005 showing BAA plc UK car parking earnings of £155m in 2004/05); Stansted Airport Ltd financial accounts for 2004/05 (showing a combined profit of £67 million from car parking, retailing and other commercial activities); Segmental profit information for UK airports in BAA plc accounts and the accounts for Stansted, Heathrow and Gatwick airports; and analysis provided in the Competition Commission report into BAA for the Q4 Regulatory Review.

⁵⁴ 'Stansted Generation 2: December 2005 Consultation', BAA, Dec 2005, p.20, col 2

⁵⁵ Heathrow Terminal 5 Inquiry, Inspector's Report, December 2000, Condition A88

⁵⁶ Ref DfT website @ www.dft.gov.uk/stellent/groups/dft_foi/documents/page/dft_foi_610468.pdf

- 70. In this connection, the judgment in the Judicial Review proceedings⁵⁷ initiated in connection with the ATWP refers, at paragraphs 249-250, to the financeability of a new runway at Stansted and the concerns of both the Treasury and the CAA that it might not be fundable on a stand-alone basis by 2012. As regards the view held by the DfT that if the runway could not be funded on such a basis "the CAA would be prepared to allow BAA to finance the runway on a system-wide basis", this runs wholly counter to the legal position as set down by the CAA in the CP and would, in the view of SSE, expose the CAA to a serious risk of legal challenge were such an approach to be adopted.
- 71. We would emphasise that stand-alone regulation needs to be applied on a genuine stand-alone basis, with a separate weighted average cost of capital ("WACC") for each designated airport reflecting its own financial structure (notably, gearing) as well as an airport-specific assessment of investment risk.
- 72. As we have previously stated, we regard the suggestion of a 'public interest levy' as a somewhat crude attempt to circumvent the stand-alone approach and revert to a form of system funding. BAA seeks to justify such a levy, of around 50p to £1.00 per passenger at Heathrow and Gatwick, in order to help fund Stansted expansion on the grounds that users of Heathrow and Gatwick would somehow benefit from the alleviation of congestion. We have seen no evidence to support the 'spillover' theory but even if this were to be a valid argument, it would be equally valid for the proceeds of the suggested levy to be used to help fund the expansion of Luton. We trust the CAA will give short shrift to the idea of a public interest levy.
- 73. We note the CAA's position that price caps should be set on the basis of regulatory fundamentals and not "in order to accommodate any particular financing arrangement adopted by BAA" (CP 35). Equally, we would argue that market fundamentals, subject to ensuring no abuse of market power, should dictate airport investment strategy. Thus the CAA should not seek to introduce any particular financing arrangements to accommodate investment plans which are not supported by market fundamentals. However, BAA appears to be looking to the regulator to do precisely that in relation to a second runway at Stansted, for example, by stipulating that "... once planning permission has been given for the development, we will only proceed with the first phase of construction if, at that time, BAA continues to have the Regulator's acceptance and support for the investment." ⁵⁸ [our emphasis].
- 74. BAA management perhaps needs reminding that just as "Governments don't build runways", neither do regulators. Ultimately, major private sector investment decisions, such as the development of a new runway, must be based upon market fundamentals. The CAA's 'building block' approach to regulation results in a cost-plus formula intended to provide the airport operator with a reasonable return on investment, taking account of the level of risk. However, with regard to major new investment, this may result in either the level of airport charges being too high for the market to bear or the level of return being too low to make it an attractive investment for the airport operator, recognising that the project will be competing with other investment opportunities available in the market.
- 75. In the case of Stansted, we believe these competing market pressures to be irreconcilable at least for the foreseeable future and that, under different ownership, the market fundamentals would move even more sharply into focus. Any new owner may have a greater choice of attractive investment opportunities, including outside the UK and in sectors other than airports. Even if Stansted remains under its current ownership, we believe that, in future, BAA management will require to have greater regard for wider investment (or non-

⁵⁸ 'Stansted Generation 2: December 2005 Consultation', BAA, Dec 2005, p.39, col 2

⁵⁷ LB Wandsworth & others v Secretary of State for Transport; Essex County Council & others v same

investment) opportunities aimed at maximising shareholder value rather than simply adding slavishly to its regulated asset base ("RAB") subject only to the CAA providing a satisfactory 'WACC-plus' settlement.

Single vs Dual Till

76. We believe that a dual till approach with a separate RAB for aeronautical and non-aeronautical assets and separate price caps to regulate charges in each of those areas would be a more appropriate basis for regulation. This would have the effect of ending the cross-subsidisation of aeronautical charges from commercial revenues and result in airport charges moving closer towards the true market price. We do however recognise that this issue was given a very full airing at the time of the Q4 review and we fully understand why the CAA is reluctant to re-open the issue so soon afterwards. We would hope that the single vs dual till issue can be revisited at the time of the Q6 review.

Pre-funding

- 77. We are concerned that the approach described in CP 22, to allow airport charges at Stansted to rise beyond the level that could strictly be justified by the CAA's conventional price regulation model, appears in effect to be a pre-funding mechanism to assist the airport operator with a project of questionable financial viability. In any event, for reasons we have explained earlier, we consider that it is unnecessary and would be wholly inappropriate for the CAA to introduce such an arrangement during Q5.
- 78. It is difficult to see how the market could be properly tested when, quite apart from the Stansted market uncertainties, there are still so many outstanding questions and difficulties in relation to the project, for example, in relation to planning, environmental mitigation costs, surface access costs, overall project cost, revenue and operating cost projections, financial viability, shareholder approval and timing.
- 79. The pre-funding of Heathrow T5 during Q4 was put in place only after the public inquiry had announced its detailed recommendations and the Government had made a final decision (November 2001) to approve the project. The planning conditions were fully known, thus enabling a realistic estimate of the cost of the project. In the case of Stansted however, BAA has not even submitted a planning application at this stage and there are a host of unknowns in relation to surface access, environmental mitigation and other matters. And whereas the pre-funding of T5 could be shared across a large volume of users and a wide and well-established airline customer base, the converse is the case at Stansted.
- 80. In addition, from 2012, substantial new runway capacity is expected to become available at Luton, which competes directly with Stansted, and there is the prospect of additional runway capacity coming on stream at Heathrow sooner than 2012, if mixed mode operations were to be approved. There would be further substantial additional capacity in the south east if a third Heathrow runway were to be approved the likelihood of which will become clearer in the course of the next 12 months or so. The prospect of new runway capacity coming on stream in the south east comes against a background of a marked slowdown in growth at Stansted and in the south east generally and a progressive shift in consumer demand to regional airports.
- 81. Despite Government policy support for a second runway at Stansted, it is by no means certain, for reasons explained earlier, that a public inquiry would endorse the project. In any event, a public inquiry is unlikely to reach a conclusion before 2009 and much can change between now and then. Government policies change and indeed Governments change. In short, we believe it would at best be premature for the CAA to support prefunding of a second runway at Stansted during Q5.

- 82. Regarding the CAA's statutory duties, including the duty to encourage timely investment, we note that these apply to all UK airports (CP C.3) or at least to some 50 airports whose turnover is more than £1m a year and not only to the four designated airports. It would, in our view, be distortionary as regards the relevant market in the south east and beyond and potentially discriminatory if the CAA were to incentivise or otherwise provide false encouragement to BAA to develop a second Stansted runway at a time when there is no firm prospect of sufficient market demand to justify the project.
- 83. It now also needs to be added that the future ownership and structure of BAA and its airport assets are, at this stage, uncertain.

D. BAA's market dominance

84. SSE welcomes the CAA's confirmation (CP 7.28) that it intends to apply Section 41 of the Airports Act 1986 to BAA in a way that is "fully in line with the application of more general domestic and EU competition law." However, we are concerned from our reading of para CP C.15 that the CAA intends, in its analysis of competition in the market, to focus on the future position rather than the present position. We strongly encourage the CAA to conduct a rigorous assessment of the present position and we see no reason to depart from the longstanding approach adopted in EU case-law where market dominance is defined as "a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers." In other words, in determining whether BAA enjoys market dominance, does its actual position in the market enable it to act abusively now? ⁵⁹

Market context

- 85. In 2005, BAA airports held 91% of the airports market in the south east and 84% of the market in Scotland, resulting in a UK market share of 66%. By any standards this represents a dominant market position and in the London/south east market in particular. Accordingly, and again consistent with EU legal principles, as a dominant undertaking BAA "has a special responsibility not to allow its conduct to impair genuine undistorted competition." ⁶¹
- 86. The position of BAA is plainly anomalous when compared to other utilities that were privatised during the 1980s and 1990s. Not only did its market dominance survive privatisation intact but also there has been no real progress since privatisation in reducing BAA's market dominance or towards encouraging greater competition and choice. This is not so much a criticism of the regulators as of the regulatory arrangements. We do however note that in other utilities sectors the relevant regulator has imposed target market share caps as a means of reducing market dominance.
- 87. We recognise that there are formidable barriers to entry into the airports market such that forced divestment over a period of time is likely to be the only effective means of reducing BAA's market dominance and introducing greater competition and choice. We also recognise the argument that almost all UK airports above a certain size enjoy a local

⁵⁹ Assessment of dominance for the purposes of Article 82, for example, involves assessment of the past or present rather than, in the case of mergers, the prospective position (European Commission Notice on Definition of the Relevant Market, OJ 1997, C372/5, para 12)

⁶⁰ CAA provisional airport statistics for 2005

⁶¹ Case 322/81, Michelin v Commission (1983) ECR 3461

monopoly - a point which suggests a wider role for the regulator(s) even if BAA's current market dominance were to be curtailed.

- 88. It is evident, on any analysis of BAA's past behaviour, that it enjoys very considerable freedom to act "independently of its competitors and customers and ultimately of consumers." We would point out, in this connection, that it should come as no surprise to the CAA (CP 7.26) that conditions imposed following Competition Commission inquiries have, in the main, been of a behavioural type rather than relating to the structure of BAA's business; the terms of reference applicable to the quinquennial reviews have effectively limited the freedom of the Commission to review the underlying structure of BAA's business and to recommend changes required to ensure the introduction of full competition in the airport sector. We believe that, following the passage of some 20 years since the privatisation of BAA, the time has come for a more fundamental investigation into the structure and operation of the UK airports market, and BAA's position in it, under the relevant competition legislation.
- 89. Looking ahead, there is an obvious risk in the case of Stansted development for BAA to abuse its market power to the detriment of non-BAA airports and we have already highlighted potential adverse implications for Luton and NEMA. If BAA is allowed to retain its present near monopoly in the south east, the CAA will require to take great care to ensure that it does not encourage or facilitate the provision of new capacity at Stansted in such a way as would provide BAA Stansted with an unfair competitive advantage vis-a-vis non-BAA airports. Genuine stand-alone regulation will be essential but, in addition, the CAA should shy away from any other measures aimed at creating more favourable investment conditions for BAA Stansted than would be generally available to any independent operator of a non-designated airport.

Market abuse

- 90. SSE applauds the decision of the CAA (CP 7.28), following the many concerns expressed by the Competition Commission during the course of the Q4 review, to adopt in future the same approach as that adopted by the Office of Fair Trading ("OFT") in dealing with conduct such as market exploitation, discrimination and predation and abusive behaviour. We note that the rule of thumb applied by the OFT in relation to market dominance is a share of 40% of the relevant market.⁶²
- 91. There have been numerous complaints about BAA's record in connection with such matters. The 2002 Report of the Competition Commission lists in excess of 100 complaints made by airlines and service providers about the treatment that they received at the hands of BAA. As noted by the Commission, ⁶³ the inadequacy of the consultation procedure between BAA and the airlines appears to have been an important contributor to the problems. It is evident from the litany of complaints contained in Chapters 12,13 and 14 of the Report that: BAA did not properly or effectively listen to complaints; in a number of material respects, BAA's prices and the levels of service provided were not cost-reflective or were arbitrary or excessive and there were inadequate controls in place to prevent such excesses; in a number of material respects, BAA's behaviour constituted a course of conduct which was unacceptable by any standards that would apply in more competitive market conditions.
- 92. Whilst there were only a small number of instances in 2002 where the Commission found BAA's activities to be against the public interest, it is also to be noted that, in relation to a number of the complaints brought to its attention, the Commission refrained from making

⁶² OFT website on Competition Act, 1998 @ www.oft.gov.uk/Business/Legal/Competition/ca982.htm

^{63 &#}x27;A report on the economic regulation of the London airport companies: Heathrow Airport Ltd, Gatwick Airport Ltd and Stansted Airport Ltd', Competition Commission, Oct 2002, para 2.559

any adverse finding only because of its inability to come to a conclusion on the basis of the evidence before it.

93. More recently, in relation to the failure of the constructive engagement process at Stansted, the Stansted Airlines Consultative Committee ("Stansted ACC") has complained bitterly to the CAA about the failure of BAA to provide essential information whilst incurring "almost £50m on preliminary expenditure without any consultation let alone agreement with the users ... BAA ignores users' needs and requirements with impunity" ⁶⁴ (whilst expecting users to foot the bill). Admittedly there may be two sides to this story but the general theme of a near-monopoly airport operator adopting an arrogant and high-handed attitude resonates with our own experience in dealing with BAA.

Designation

- 94. The original designation of Stansted was unjustified given the small scale of the airport in 1987 and the fact that it had no market power at that time. We can only surmise that the reason for its designation was to allow Stansted's development to be cross-subsidised by users of Heathrow and Gatwick airports paying higher airport charges than would otherwise have applied.
- 95. However, assuming that genuine stand-alone regulation will be applied in Q5 (and beyond) Stansted should continue to be designated now that it is beginning to enjoy some market power and is in a position to abuse this. Moreover, if BAA is permitted to retain its present market dominance in the south east and Scotland, there is a strong case for all of BAA's UK airports to be designated. (We make this recommendation in the knowledge that a form of 'shadow' regulation already applies to BAA's airports in Scotland.) As well as having merit in itself, given the market power of BAA in the south east and Scotland, the designation of all BAA's UK airports would facilitate a more robust approach to regulation, for example, by reducing the scope for skewed apportionment of central costs and revenues. We therefore encourage the CAA to consider making a recommendation to the Secretary of State to the effect that all of BAA's UK airports be designated.
- 96. Purely as an observation, we believe that if, as projected in the ATWP, runway capacity in the Midlands becomes tight during Q7 and perhaps sooner than that if regional growth continues to be higher than projected at the time of the ATWP there may well be a case for the designation of Birmingham International Airport, at least on an interim basis pending new runway capacity coming on stream in the Midlands.

Scope for inter-terminal competition

97. We have not studied in any detail the assessment carried out at Dublin Airport of the scope for inter-terminal competition but we have considerable doubts as to the practicality and usefulness of this approach in relation to Stansted and, indeed, generally. More fundamentally, the Dublin study was aimed at addressing the issue of choice and competition in the context of a single airport monopoly. This is not the case as regards London where there is a far simpler and far more effective way of increasing choice and competition, namely, ending the common ownership of Heathrow, Gatwick and Stansted.

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⁶⁴ 'Response to CAA Consultation Document – Economic Regulation of Designated Airports from 2008: CAA Process for the Reviews', Stansted ACC, Nov 2005

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Specific questions set down in the consultation document

Our brief comments below, in response to the questions listed in Annex F of the CP, are cross-referenced to relevant paragraphs in the main body of our response and should be read only as pointers to our main response.

- 1. We believe that the CAA may have underestimated the very significant changes in the landscape since the publication of the ATWP both in relation to demand and supply and the implications thereof [paras 6-33].
- 2. The CAA should also have regard to: the "balanced and measured" totality of the ATWP [paras 44, 46]; Government policy with regard to reducing car use in favour of public transport, especially rail (since this will need to be applied to the future surface access strategies for airports) [paras 62-68]; and the increasing efficiency of capital markets seeking the most attractive returns, globally, with regard to (e.g.) the funding of major infrastructure projects [paras 74, 75].
- 3. Broadly yes, although we are concerned that the CAA may be placing disproportionate emphasis upon its duty to encourage timely investment at designated airports and appears intent upon ensuring that airport development costs, including surface access costs and possibly also environmental mitigation costs, are kept to a minimum [paras 22, 23, 33].
- 4. We believe so.
- 5. Yes, provided the totality of the ATWP is considered and proper weight is also attached to policies set out in other Government White Papers which have a direct bearing upon the issues under consideration and the implications thereof [paras 44-68].
- 6. We have a number of reservations [paras 12-33, 84].
- 7. Again, we have a number of reservation [paras 6-18, 30-33].
- 8. We do not believe that pre-funding is appropriate. Lumpy investments should be handled in the same way as in the competitive market place, whereby the investor bears the risk and the negative cash flow impact in the short term, in the expectation of attractive returns on his investment in the longer term. To do otherwise would be to run the risk of distorting the market and discriminating against other competing operations [paras 22-23, 33, 77-83].
- 9. Yes, although we are concerned that the CAA has even entertained the idea of a 'public interest levy', which would have the effect of allowing inter-airport funding [paras 22-23, 69-72].
- 10. We support a dual till rather than single till but we recognise that it may be too soon to revisit this issue in view of the extensive consideration given to this at the time of Q4 review. We would hope that the single vs dual till debate can be reopened at the time of the next (Q6) quinquennial review [para 76].

- 11-12. No comment.
- 13. In the event of BAA's UK airports remaining under common ownership, all seven should be designated [paras 94-96].
- 14. We support the suggested regulatory principles for the treatment of surface access costs but emphasise that the approach should not seek to minimise surface access costs and should have regard to Government policy to achieve a radical shift from private to public transport, especially rail. In addition, the outcome of the planning process should not be anticipated with regard to the surface access planning conditions and possible constraints placed upon airport car parking [paras 49-68].
- 15. This appears to be a clear reference to Stansted and we repeat the response at 14, above, and our reference to paras 49-68 in our main submission.
- No comment.
- 17. See our comments on BAA market dominance and abuse thereof [paras 84-96]. We believe that the time has come for a full investigation into the structure and operation of the UK airports market, and BAA's position in it, under the relevant competition legislation.
- 18. We have considerable doubts as to the practicality and usefulness of interterminal competition in relation to Stansted and, indeed, generally [para 97].
- 19-21. No comment.
- 22. Yes.
- 23. Efficiency of the capital structure in terms of maximising shareholder value.
- 24. Yes, but note that this should be applied separately for each designated airport, reflecting their individual capital structures and risk profiles [paras 69-72].
- 25. No. This would be extremely unlikely to feature in a competitive environment [paras 73-75].
- 26. Yes.
- 27-32. No comment.
- 33. Yes [paras 84-93].
- 34. As per 33 above.