

Regulatory Policy Group
Economic Regulation

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Dear Tim,

CAA consultation on charges for 2013/14

Thank you for your letter of 27 November 2012 to Chris Jesnick, which asked for some further information on the CAA's charges proposals. Chris has asked me to respond on her behalf. I have tried to answer your questions in turn.

- The CAA's view of whether, absent Stansted's request, the CAA would have needed to assess Luton's market power in due course, and the reasoning behind this

I would like to quote Iain Osborne's letter of 3 May 2012 to Nick Barton, which responded to your initial request for a market power assessment of Luton:

"...we assess each airport's market power on its own merits. It is not the case that the CAA needs to undertake an assessment of Luton – or of the other airports that impose competitive constraints on Stansted, or that share some characteristics with Stansted – in order to reach a robust view on Stansted's market position. Indeed, the CAA has published Guidance on the Assessment of Airport Market Power, to support consistent and coherent analysis of airport market power."

We are only undertaking the assessment of Luton's Airport market power at the present time as this was requested by Stansted Airport. In the absence of this request we would not be undertaking this work now and it would only be conjecture if I said that the CAA would or would not be doing this in the future. For example this would depend on whether we received a request from another interested party or there was sufficient evidence to suggest that such an assessment would be worthwhile.

- The CAA's view of the benefit to consumers (generally) and to other London airports of the CAA assessing Luton's market power

It is difficult to speculate on the benefit to consumers and to other London airports of the CAA assessing Luton's market power. If the CAA found that Luton had substantial market power and that the benefits of licence regulation outweighed the adverse effects, then there could be benefits from this assessment (if these net benefits were sufficient to outweigh the costs of the assessment itself). If the CAA thought that the potential consumer benefits of

assessing Luton's market power were sufficiently compelling then the CAA would be undertaking the assessment now, however the CAA does not currently consider that this is the case. The CAA will keep the position under review.

- A detailed breakdown of the estimated costs associated with the assessment of Luton's market power

The estimated costs of £150,000 for the Luton Airport market power assessment should be regarded as indicative as the CAA will not complete the detailed planning for this work until the end of 2013 (see Iain Osborne's letter to Nick Barton of 2 July 2012). Irrespective of this the CAA would not expect to release a detailed breakdown of the expected expenditure as this could prejudice the CAA's commercial interests by providing potential bidders for consultancy work an indication of the individual sums available. As Iain Osborne stated in his letter of 2 July 2012, market power assessments require significant resource, and the CAA is already undertaking market power assessments at three airports. Consequently the market power assessment at Luton Airport is likely to involve a greater level of consultancy than would be the case for the other airports.

- For each work-stream of the Luton assessment, the scope of work envisaged and an explanation of the reasons why the CAA considers it necessary to seek consultancy advice.

Please see my answer to the previous question.

- An assumption on the form of Q6 review for Stansted that has been assumed for the purposes of allocating costs between airports

The CAA has made no assumption on the form of regulation at Stansted, or indeed, at any other airport, on the allocation of expenditure for the Q6 review. It is important to note that for comparison purposes the CAA will be estimating a potential RAB based price cap for each airport and so much of the work will be common irrespective of the form of regulation.

- A detailed breakdown of the overall predicted costs associated with the assumed Q6 reviews for the three designated airports

As set out above, the CAA does not consider that it would be in its or the airports commercial interests if we were to set out the detailed breakdown of expenditure assumed for the Q6 review.

- A description of how the actual costs associated with any Q6 review will be reconciled with the estimated costs

As stated in Iain Osborne's letter to you of 16 April 2012, the cost of consultancy studies for the price reviews is recovered through the Airport Review charge. This charge is intended to recover no more and no less than the actual external consultancy costs incurred by the CAA in respect of the periodic review under section 40 of the Airports Act 1986. These charges reflect the predicted external consultancy spend at each designated airport, with individual charge rates being based on the ability to recover these costs by arriving passenger forecasts.

Actual external costs relating to the review are carefully monitored and reconciled throughout the year against the income levels received from each airport. However, given the element of uncertainty relating to resource requirements for the reviews and the accuracy of the passenger forecasts, any under recovery of costs within the year would be charged in subsequent years, whilst any anticipated over recovery within the year would cause the charge to cease at the point the external costs had been met.

- A description of the expected Stansted-related consultancy spend in 2012/13

Following discussions with yourselves about the potential impact of consultancy work in 2012/13 in particular on the sale process, the CAA has focused external advice in relation to Stansted Airport in the following areas: employment unit cost and top down operating cost benchmarking, comparing and capping charges across airports, long run incremental costs, price monitoring, passenger research and cost of capital/finance issues. The CAA reserves the right to undertake further work consultancy work on Stansted Airport as necessary during the remainder of 2012/13.

- A description of how these expected costs have been arrived at, and where relevant, allocated between the three designated airports

In 2012/13, for the three designated airports external costs are currently estimated to be £2006k (£1550k professional fees, £150k legal fees and £306k VAT) 40% of the professional fees have been allocated to each of Heathrow and Gatwick and 20% to Stansted. Legal fees have been allocated equally across all three airports.

- The CAA's reconciliation between the anticipated and expected level of Stansted-related costs

Please see my answer above as to how the actual costs associated with any Q6 review will be reconciled with the estimated costs. I am afraid it is not possible to reconcile forecast and actual consultancy spend on Stansted Airport for 2012/13 as further consultancy may be commissioned during the remainder of the financial year.

You mention that the Airport Charge Review for Stansted Airport should take into account the CAA's view of the need to explore 'more pragmatic, simple and transitional' approaches to regulation. As previously stated the CAA is considering the form of regulation at Stansted and is therefore undertaking further work on price monitoring, long run incremental costs and comparing and capping airport charges. The CAA also considers it necessary to undertake work on RAB-based building blocks, as a minimum to provide a counterfactual to any alternative form of regulation.

You have requested that the CAA contact Stansted Airport directly when consulting on future charges. The CAA does not expect to contact all stakeholders individually when it publishes charges consultation, but would hope stakeholders would have arrangements in place to decide which CAA publications it wishes to comment upon. We appreciate that Stansted's situation within the BAA group has been unusual in recent months, but imagine that issues this has caused will not recur in future years

I trust this answers the points raised in your letter and allows you to respond to our consultation.

I will be putting a copy of this letter on our website so other parties have access to the same information when responding to our consultation.

Yours sincerely,



Tim Griffiths