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Dear Barbara

Review Of Price Regulation at Heathrow, Gatwick and Stansted Airports
Q6 Policy Update: May 2012

The stated purpose of your latest Q6 policy update document is to set out your current thinking on the most appropriate regulatory arrangements for Heathrow, Gatwick and Stansted airports after the present controls expire in March 2014, and to seek stakeholders' views. We wish to comment on your fourth question only, namely: 'What is your view on the rationale for economic regulation at Heathrow, Gatwick and Stansted?'

In our submissions of 24 November 2011 and 6 April 2012 we highlighted the DfT's August 2011 assessment that '*London's airports will be operating close to their full capacity by 2020 and by that time there will already have been some spillover of traffic from Heathrow to other airports.*'¹ The CAA endorsed that assessment in '*Aviation Policy for the Consumer*'², concluding that capacity constraints may already be adversely affecting airports in London and the south east.

Why then, does the CAA continue to disregard the predicted capacity shortage at London's airports when assessing their market power? Your latest policy update claims that 'The CAA is undertaking a thorough analysis of the rationale for continued economic regulation at Heathrow, Gatwick and Stansted' but your analysis cannot reasonably be described as 'thorough' when:

- You have only sought to assess the market power of the three London airports which are currently subject to economic regulation and have assessed each on a stand-alone basis;
- There has been no attempt to assess the market power of the other London airports;
- You have based your market power assessments largely on the historic data rather than the projected position in the relevant period, April 2014 to March 2019.

¹ 'UK Aviation Forecasts, DfT, Aug 2011, see, for example, para 2.111 and Table 2.15.

² 'Aviation Policy for the Consumer', CAA Insight Note, December 2011.

In *Aviation Policy for the Consumer*, the CAA refers to the DfT's forecasting model and explains how this generates 'fare premia' (shadow costs) for passengers using airports operating at their capacity, with the total value of such fare premia predicted to total £1.7bn by 2030. Figure 26 in *Aviation Policy for the Consumer* graphs the predicted onset of fare premia over this period at Heathrow, Gatwick, London City, Stansted and Luton airports as each in turn reaches capacity.

It is axiomatic that in this type of sellers market all of London's airports would acquire significant market power and are likely to engage in oligopolistic pricing behaviour unless subject to close regulatory scrutiny.

Finally, some argue that the predicted capacity shortage at London's airports is not imminent and so can be disregarded as an issue for Q6, at least in relation to Stansted (and Luton and London City). However, even if this were judged to be the case at Stansted, it would run counter to the principle of minimising regulatory uncertainty if Stansted were to be de-designated in Q6 with an expectation that it would be re-designated in Q7.³

Yours sincerely



Brian Ross
Economics Adviser

³ We have used the terms 'Q6' and 'Q7' for simplicity and understand that the future regulatory approach may not be based around five year terms.