



Regulatory Policy Group
Economic Regulation

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5 October 2012

Dear Tim and Ian,

Stansted Airport Mid Constructive Engagement (CE) Review

Thank you for your joint letter of 25 September which provides a report on the progress to date of CE at Stansted.

This letter sets out the CAA's assessment of CE at Stansted based on:

- your progress report as co-chairs; and
- the meeting with the CAA on 26 September.

Mid-term Review Meeting

I thought it would be useful to summarise the positive discussion we had at the mid term meeting on 26 September.

The airlines agreed to use the airport's traffic forecasts as the basis for further CE discussions. Whilst not accepting the forecast *per se* for Q6, they broadly accept the macro-economic assumptions on which it is based.

The airport and airlines agreed that it would be useful to continue CE and have scheduled three further meetings in October, November and December. The parties believe a large measure of agreement can be reached around service quality and the SQR. It was agreed that the December meeting will be devoted to this topic.

With regard to capital expenditure, the airport provided an update to the capital programme value for Q6. The majority of the value in the Q6 investment programme relates to renewals expenditure. The airlines did not feel there was much value in considering the traffic related element but will discuss the renewals programme and provide their views on the prioritisation of projects. The airlines stated they can add more value in this way, than by seeking to review the cost or efficiency of capex, which if required should be undertaken by

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the CAA. The airlines also wish to progress discussions on opex efficiency as they believe in this area their operational and process experience is highly relevant. The airlines have requested additional opex cost data e.g. daily reports of sickness, which has not yet been provided. STAL has not yet decided whether it will provide this information as the airport considers engagement on capital investment should precede engagement on operating costs and has already provided the airlines with a significant amount of roster related data, although accepted that the airlines are still waiting for certain clarifications.

There was some debate about the order of the future CE discussions. The CAA suggested that both opex and capex should be on the agenda of the October and November meetings. The airlines agreed to this suggestion at the meeting as a good way forward, however, the airport reserved its position and in a subsequent letter has failed to clarify whether it will accept the CAA's suggestion whilst maintaining the view that that it would be more productive to consider capex first.

STAL is also concerned that until the CAA has reached a view on SMP and the appropriate form of regulation it would be obtrusive to conduct further detailed investigation of opex costs. The airport requested that the CAA defers its consultancy work until after the preliminary SMP decision. The CAA has taken this point into account in the guidance set out below.

CAA expectations and guidance

The CAA is providing informal guidance to assist the parties complete CE. This does not constitute a change to the CE mandate. The CAA welcomes the positive approach taken by both parties at the mid-term review meeting. It encourages the parties to:

- continue CE with the aim of reaching agreement on the SQR regime;
- the airlines should also provide a clear response to the capex renewals programme proposed by the airport with a prioritisation of the projects;
- the airport should respond to the airlines request for additional opex information within 5 days of this letter and inform the airlines and CAA of its decision;
- not delay further either discussions of renewals capex or opex efficiency, i.e. discussions should take place concurrently;
- the parties should as far as possible reach agreement on opex cost efficiency and/or identify the key issues for the CAA part of the review.

In parallel to CE the CAA is undertaking its own work to inform its initial proposals. The CAA has commissioned the following consultancy studies which cover Stansted Airport.

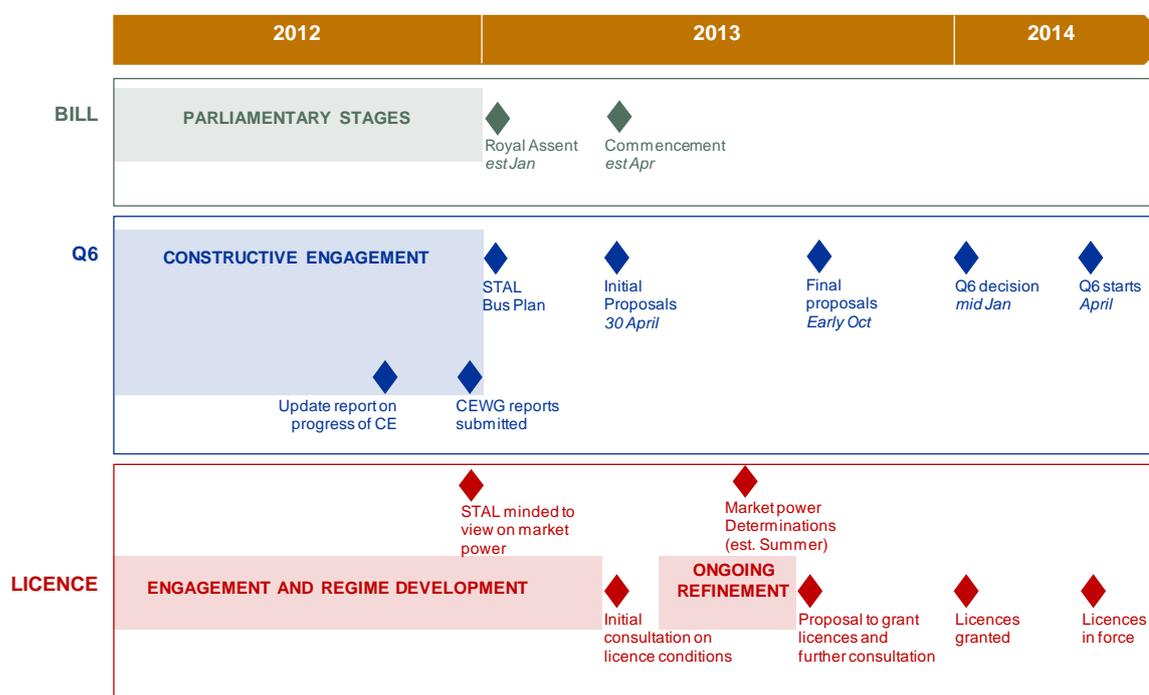
Title	Consultants	Expected completion date
Comparing and capping airport charges at regulated airports ¹	Leigh Fisher	October 2012
Heathrow, Gatwick and Stansted employment cost study ²	IDS	October 2012
Passenger satisfaction of arriving, departing and connecting passengers	Being undertaken by CAA's own survey team	January 2013

After considering the points made by STAL the CAA has decided, at this time, not to commence further consultancy work at Stansted focused solely on standard RAB-based building blocks, but will allow the parties the space for discussions about opex and capex in October and November. It may however decide to commence the work before the December SMP decision if it feels this is necessary to meet the Q6 timetable.

Timetable for Q6 review

Based on the progress of the New Civil Aviation Bill and work so far on the Q6 review the CAA envisages the following updated timetable for the remainder of the review. In October 2012, the CAA expects to write to each of the airports to set out its requirements for the January Q6 business plan and the process for submitting updated information during the Q6 review.

The CAA intends to adopt the timetable set out in the diagram.



¹ The terms of reference for this study is at: [http://www.caa.co.uk/docs/78/1387SO25Spec%20\(2\).pdf](http://www.caa.co.uk/docs/78/1387SO25Spec%20(2).pdf)

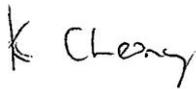
² The terms of reference of this study is at: <http://www.caa.co.uk/docs/78/1387SO26Spec.pdf>

Apart from consultancy studies mentioned above and the market power assessment, the CAA has no current intention to publish material ahead of its initial proposals in April 2013. The CAA will, however, keep this under review and will consider publishing further information or analysis if to do so would inform or assist the CE process.

On the timing of consultations during 2013, the CAA would publish its initial price control proposals for consultation at the end of April 2013, followed by stakeholder meetings with the CAA Board in July.

The CAA will then prepare its final proposals for publication in October 2013. The CAA requires any information that is likely to have significant implications for the price control such as changes in traffic or capital or operating expenditure forecasts to be provided by 20 July 2013 so that it can be taken into account in the final proposals. All parties should assume that any substantive new information provided after this date, will not generally be taken into account, especially if could have been generated earlier and other parties have not had the opportunity to comment.

Yours sincerely,

A handwritten signature in black ink that reads "Ken Cheong". The signature is written in a cursive style with a large initial "K".

Ken Cheong
Head of Price Control Regulation