

that would have facilitated such competition.

Second, the CAA proposes that there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted Airport. This applies whether or not the modification would occur via an application under section 40(6) of the Airports Act 1986 (sometimes referred to as a mid-quinquennial review) or in resetting price controls for a further five year period starting on 1 April 2014 (assuming that the current Airports Act 1986, and the designation of Stansted Airport for price control purposes, remained in place).

Third, the CAA intends to put in place a work programme to develop further its thinking on alternative approaches to price control regulation that facilitate – rather than distort – competition. The CAA has already identified that safeguard caps can provide a useful alternative to RAB-based price control regulation. Moreover, the CAA notes that the Competition Commission, while deciding against a Long Run Average Incremental Cost (LRAIC) approach for Stansted in Q5, identified that as a LRAIC based price cap could result in prices closer to the long-run competitive level, it could provide better signals to the market for efficient entry, investment and innovation. Nevertheless, there is scope to investigate these options further – consulting, as appropriate, with interested parties – so as to establish whether such alternative approaches might represent more effective ways of meeting the CAA’s statutory duties over the longer-term, particularly as competition develops and large-scale investment is contemplated. The CAA is, therefore, intending to initiate work during Q5 to ensure that safeguard price control approaches are sufficiently well developed to provide credible alternatives to the RAB-based approach.

The CAA would expect the scope of this work to include:

- periodically assessing the degree of competition between airports;
- identifying and assessing alternative approaches to price regulation, as competition intensifies;
- carrying out work on estimating forward-looking costs of airport development (including, but not necessarily limited to, Long Run Average Incremental Cost) that could serve to inform judgements about price controls in future; and
- considering how alternative approaches to setting price controls would best be applied in practice.

This work should help economic regulation effectively to adapt to changing circumstances, following the completion of the Competition Commission’s market inquiry and BAA’s disposal of Gatwick Airport. The CAA would envisage that this work would take place in the first two years of Q5, and would therefore provide a backdrop to any modification or resetting of the price control.

The CAA is the UK’s independent aviation regulator, with responsibility for all civil aviation regulatory functions: economic regulation; airspace policy; safety regulation; and consumer protection.

The CAA’s statutory duties: The CAA must set price controls on designated airports in a manner which the CAA considers is best calculated:

- ‘(a) to further the reasonable interests of users of airports within the UK;
- (b) to promote the efficient, economic and profitable operation of such airports;
- (c) to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
- (d) to impose the minimum restrictions that are consistent with the performance by the CAA of its functions.

...and in doing so, take account of...international obligations of the UK.’

The Competition Commission’s Market Investigation into BAA’s Airports

Alongside the quinquennial review process, Stansted is also currently subject to a parallel Competition Commission market investigation into BAA’s airports. In September 2008, the CC published its provisional findings, which concluded that BAA’s ownership of three London airports, and Glasgow, Edinburgh and Aberdeen in Scotland, had adverse effects on competition. As a consequence, the CC has provisionally found that divestment of two of BAA’s London airports and one of its Scottish ones could remedy the situation. The CAA strongly supports this finding and has submitted evidence to the CC suggesting it could strengthen its case for divestment by focusing on the possibility for competition in the short term as well as the long term. Following these provisional findings, BAA undertook to offer Gatwick Airport for sale. The CC will publish its final report by March 2009.

in focus

a briefing from the Civil Aviation Authority - 09 December 2008

Stansted Airport: CAA consultation on price control proposals

The Civil Aviation Authority (CAA) has published its proposals for price controls on airport charges at Stansted Airport for the five-year period between 1 April 2009 and 31 March 2014. The controls limit the amounts which Stansted can charge airlines for using the airport. These proposals are informed by recommendations from the Competition Commission (CC) and over two years of consultation and work within the CAA.

Subject to evidence from its final consultation period, the CAA proposes the following maximum charges for Stansted Airport:

● **Price caps will be £6.34* per passenger for the first two years. The caps will then rise by retail price index (RPI) inflation +1.63 per cent each year to £6.65 by 2013/14, to enable both Stansted and other competing airports to take forward plans for expansion to meet demand from passengers efficiently.**

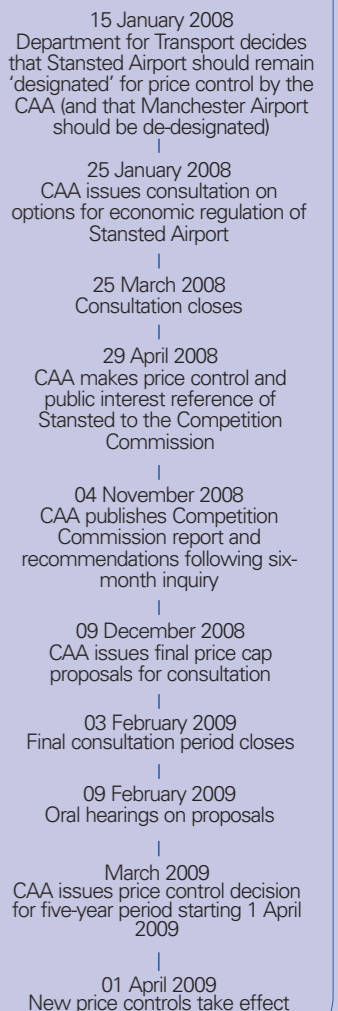
● **These price caps are based on the total revenue recommended by the CC, but adjust the maximum charges down to take account of non-passenger (mainly cargo) revenue.**

Action has also been taken by the CAA to ensure high standards of customer service at Stansted by putting in place a financial incentive regime under which BAA would be liable to repay airlines up to seven per cent of its airport charge revenue if it fails to deliver good service to its passenger and airline customers.

The CAA also sets out today how regulation in the future could be improved to ensure cost effective expansion at Stansted and other airports. This work is looking beyond the proposals outlined today for the price control for 2009-2014.

**all figures in this document are in 2008/09 prices unless otherwise stated*

Timetable



Background

The CAA is required to set price caps on airports that have been 'designated' for price control by the Government. After a review during 2007, the Government confirmed in January 2008 that Stansted Airport should remain subject to price control. There are currently three such designated airports – Heathrow, Gatwick and Stansted – and over fifty other UK airports that are not subject to price regulation. Manchester Airport is also currently designated, but will be de-designated from April 2009.

This is the fifth time that a price control has been set for Stansted; once by the Department for Transport in 1987; and then subsequently on a five yearly basis by the CAA.

In March 2008, after a similar review process as that for Stansted, the CAA set price control and public interest conditions for both of Heathrow and Gatwick for the five years between April 2008 and March 2013.

Leading up to these final proposals for Stansted, the CAA consulted on a range of options for this price control in January 2008. It then made a mandatory reference of Stansted Airport to the CC, for a six-month review, in April 2008. The CAA published the CC's recommendations for Stansted's price control in early November 2008. Following this final consultation period, the CAA will issue in March 2009 its final decision for the Stansted price controls for the period April 2009 to March 2014.

Context

BAA's London airports (Heathrow, Gatwick and Stansted) are each major nodes of the UK transport system, and the UK's international transport network. Stansted has, over the past decade, experienced the fastest growth of any major UK airport, becoming a key airport for no-frills operators and seeing significant growth in leisure, including 'visiting friends and relatives', traffic.

Previous price caps on Stansted have not had a significant impact on the prices actually charged by the airport or its service.

Instead, normal commercial and competitive pressures have protected passengers and airlines.

BAA has brought forward plans to expand significantly capacity at Stansted Airport, by constructing a second runway and associated facilities.

The role of economic regulation

The purpose of the CAA's economic regulation of the three airports designated by the Government for such regulation (Heathrow, Gatwick and Stansted) is to protect airport users (passengers, freight shippers, and airlines) from the unreasonable exploitation of market power by each airport. In doing so, and in accordance with its statutory duties, the CAA must also promote the efficient, economic and profitable operation of UK airports, and encourage investment in time to meet demand.

The CAA has certain tools under the 1986 Airports Act with which to undertake its economic regulation of airports:

- price control conditions set every five years; and
- specific conditions designed to remedy any actions by the airport against the public interest (as determined by the Competition Commission in its quinquennial review of each designated airport).

The broader performance of each airport over time is primarily the responsibility of the airport operator and is dependent upon its management of a wide range of commercial and stakeholder relationships.

From the passengers' perspective, the overall airport experience also depends on the performance of other parties, including airlines, their agents, and the Border and Immigration Agency, amongst others.

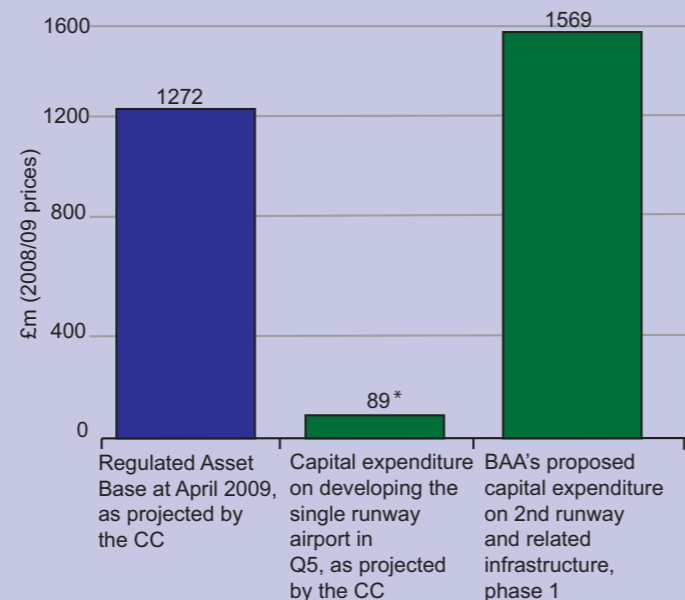
The Competition Commission's Report

The Commission recommended that maximum airport charges at Stansted rise to £6.56 per passenger in 2009/10, with charges subsequently increasing by no more than RPI plus 1.75 per cent each year, reaching a maximum of £7.05 per passenger in 2013/14.



Figure 1: Airports within a four hour drive time of Stansted Airport with more than 0.25 million international scheduled passengers in 2007.

Figure 2: Stansted Airport's asset base and proposed future capital investment.



* This figure excludes capital expenditure due to fall in Q6

This compares with projected charges for 2008/09 of £6.34 per passenger. (All figures quoted in 2008/09 prices.)

Under the Airports Act 1986, the CAA is required to have regard to the Commission's recommendations in respect of setting the level of price controls for the coming five-year price control period. However, subject to that requirement, the CAA's final proposals are its own responsibility and must be made within the statutory powers and duties given to the CAA.

The proposal

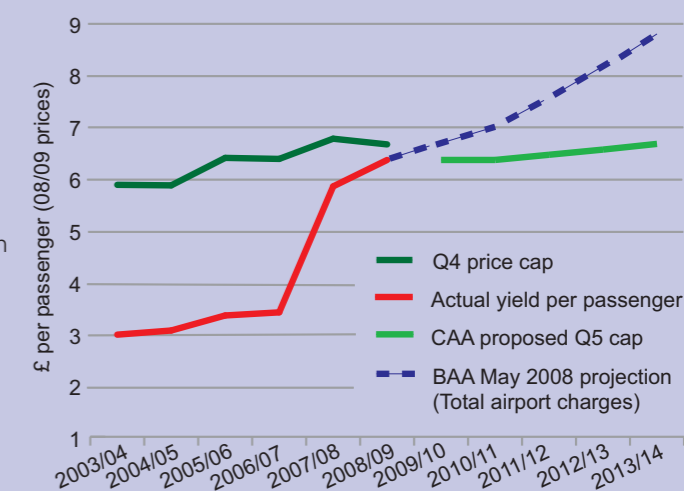
The CAA's proposal today is in line with the total revenue suggested by the CC for the period, with two principal changes leading to a different profile over the quinquennium. Firstly, the CAA proposal takes into account revenue from non-passenger (mainly cargo) flights, which was omitted from the CC report, meaning that the CAA's price control is equivalent to the CC's recommendations less an adjustment for that revenue. Secondly, the CAA profile keeps constant the price caps for two years, and then allows increases to the level implied by the CC's recommendations over the final three years of the quinquennium.

Price control profile

The CAA has attached importance to ensuring that its price cap proposals are consistent with the development of competition. This has been achieved by proposing a price cap profile that:

- would not require airport charges to fall in real terms, with the consequent risk of an unduly adverse effect on rival airports;
- would involve rising prices in years three to five, consistent with the direction of prices that might be expected over a period in which capacity constraints are likely to tighten (albeit not as far or as fast as had been predicted prior to the economic downturn); and
- that would mean that, were prices to continue to move in the same direction beyond 31 March 2014, prices could be expected to rise to levels broadly consistent with the CAA's current range of estimates of the incremental cost of supplying airport capacity by the time major new investment could be undertaken.

Figure 3: Stansted Airport price caps and airport charge revenue from passenger flights.

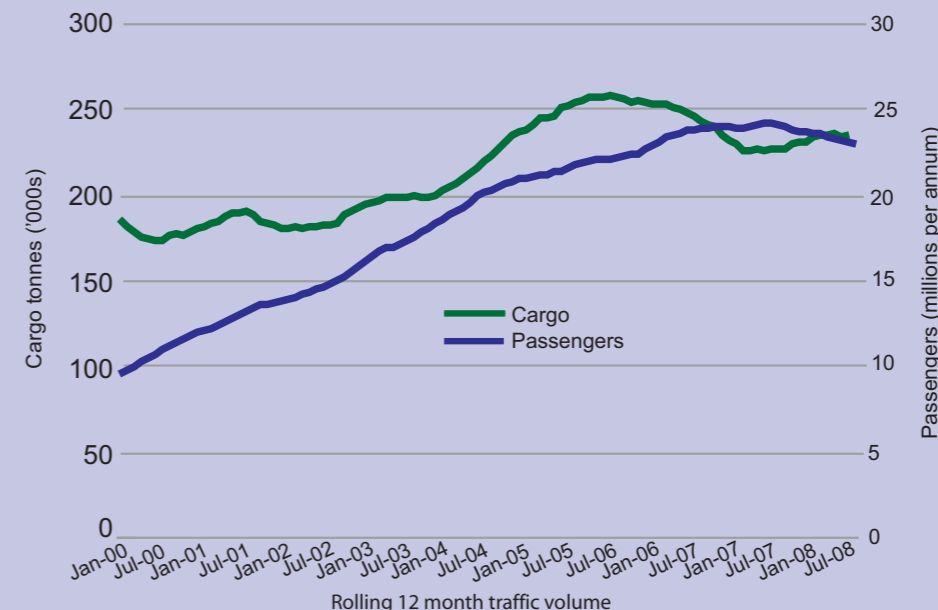


The CAA agrees with the CC's conclusion that the costs and benefits of this project do not need to be factored into the Q5 price controls at this stage.

Addressing the risks of adverse behavioural effects

At the same time, the CAA believes it is necessary to address the risk that incentives created by Regulatory Asset Base regulation could have substantial adverse effects on the behaviour of Stansted Airport and its airline users, which could in turn distort competition to the detriment of users at Stansted and other rival airports.

Figure 4: Recent trends in traffic at Stansted Airport.



The CAA proposes to address this risk in three ways. First, by emphasising that there is a dual rationale for the CAA arriving at the profile set out above. It is the product of both the building-block analysis that has been carried out by the Competition Commission and the CAA's assessment that the resulting price control profile is consistent with the development of more effective competition between airports over time. Indeed, had the CAA not been able to satisfy itself on this latter point, the CAA might have had to consider adopting a price cap