

AIRPORTS REVIEW – POLICY UPDATE: COMMENTS BY DAVID STARKIE, JUNE 2006

- 1 This comment is in the context of the policy update to the Airports Review, May 2006, (the ‘document’) and focuses on issues raised directly and indirectly in Chapters 3 to 5 of the document. Specifically, it draws particular attention to the commercial context within which the Airports Act, 1986, was intended to operate. Although the CAA document comprehensively reviews the statutory framework and duties placed upon it (Chapter 3), the commercial context within which the airports industry operates tends to be addressed indirectly by reference to the CAA’s duty to promote the efficient, economic and profitable operation of airports. An efficient, economic and profitable outcome would of course be the consequence of a fully competitive market in airport services.
- 2 The 1986 Airports Act was the enabling Act for the privatisation of BAA and it also facilitated privatisation of the airport industry (Part II of the Act); since then much of it has been privatised. The Act also enabled airports to be ‘designated’ and thereby subject to the regulation of prices when it was expected that the airport concerned could exercise significant market power. (Previously, ownership by the public sector was considered synonymous with acting in the public interest). And in those cases where an airport remained in the public sector, it was expected to adopt a commercial policy and to prepare statutory accounts. As the Airports Policy White Paper of June 1985 said: “Airports, whoever their owners, should normally operate as commercial undertakings”.
- 3 The present Government and its predecessors since 1997 have not changed this statutory framework or sought to change the ownership structure of the industry. Therefore, the CAA’s general approach to the airport industry is set within this general context of a commercially driven industry and, as noted above, its specific duties have to have regard to the industry’s profitability, amongst other matters. Although the CAA has concluded (paragraph 3.4) that it will base its decisions in the price control reviews on its overall assessment of how the combination of regulatory policy decisions are together best calculated to meet its statutory duties taken as a whole, it could be argued that primacy should be given to profitability and, thus, to the commercial viability of the industry as a whole.
- 4 Consequently, arguments for and against the proposition that stand-alone pricing is best suited to serve the interests of users and that it encourages timely investment, have to be considered in the round and not specifically with reference to any one airport operator. In this broader context, stand-alone pricing by avoiding market distortions and unfair competition, might be considered to encourage timely investment at, for example, Luton Airport. In contrast, a system approach which would allow BAA to leverage the market power of Heathrow for the benefit of Stansted, could harm Luton’s plans to have a realigned runway in place by 2012, *or the future return on that investment*. Equally it could affect the return on investments at other airports such as Southend where a new terminal

- will open later this decade. Such leveraging of market power in one part of the market to the detriment of service providers elsewhere in the same product and geographic market would seem to be contrary to the spirit of the 1986 Act and the *raison d'être* for designation, which was to guard against the abuse of significant market power.
- 5 As the CAA's document points out (para 2.29), the December 2003 White Paper, 'The Future of Air transport', does not itself authorise or preclude any particular airport development; its intention is to guide and inform *specific* planning applications (W.P. paragraph 14). The White Paper also adds that "The Government will not promote ... the development of Stansted", although it supports development at Stansted of the first *new* runway to be built in the south-east. But, equally, the White Paper adds that "The Government supports the growth of Luton up to the maximum use of a [*new*] single full-length runway based broadly on the current alignment ...". The latter is but one example of a commercial investment that could be prejudiced by an expansion at Stansted, premature in strict commercial terms, the timing of which was made possible only by the leveraging of market power at Heathrow.
 - 6 It might be argued, therefore, that there is tension, if not a contradiction, in the White Paper's implicit attempt to 'pick winners' and, in the process, disregard the commercial imperatives of a largely privatised airport industry. A similar degree of confusion is manifest also in the view that a second runway at Stansted should be built once the demand (*sic*) for travel in and out of London exceeds available runway capacity. However, this is not a criterion that a commercially-driven organisation would use as a basis for investment planning. It is of course correct, as BAA have pointed out (BAA/Q5/164, para. 12), that the CAA's stand-alone policy will lead to 'lost' traffic, which is not taken into account in the CAA's assessment. But, by definition, such traffic will not be willing to pay the costs of Stansted's early expansion and therefore it is to be expected that a commercially minded BAA will be indifferent to such 'losses'. It is to be stressed again that the intent of the Act that provides the current statutory framework, the 1986 Airports Act, was not to mould an airport industry around first-best principles of social welfare maximisation; rather it was to place it in the context of markets, competition and commercial imperatives.
 - 7 The stand-alone approach serves also to further the reasonable interests of Stansted users because it is more likely to secure expansion of a type consistent with their needs. In contrast, the 'system' approach essentially severs the commercial link between user and airport; it allows for *any* project to be financed regardless of user preferences. In the context of user preferences, it should be borne in mind that the airlines operating at Stansted operate in a very competitive market and therefore, through market forces, the airlines will be reflecting the interests of their customers. It is for this reason that the distinction made between 'airlines' and 'passengers' when debating the reference in the Statute to 'users' (see, for example, para 3.10-3.13 and 3.34) is increasingly artificial. Competition

has conflated the distinction. Moreover, it is to be noted that there is an important distinction between the duties placed upon the CAA in the 1986 Act and the legislation that underpins the duties of other regulators in relation to their regulated industries. It is generally the case that other regulators are required to protect the interests of consumers. In the CAA's case, it is required to further the interests of users. In this context, it would seem that to give equal weight to both passengers and airlines is not necessarily inappropriate.

8 I am happy for this Comment to be placed on the CAA's web-site.