News Release

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CAA PUBLISHES CC STANSTED AIRPORT CHARGES REPORT

The Civil Aviation Authority (CAA) has today published the Competition Commission's (CC's) report and recommendations on charges at Stansted Airport, which will govern how much the airport's owner, BAA, can charge airlines during the five-year period beginning April 2009. The report is available on the CAA website at: www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=10232 and on the CC website at www.competition-commission.org.uk.

The CC is recommending an increase in the maximum level of airport charges at Stansted to £6.26 per passenger,[1] compared with the current level of actual charges of £6.05 per passenger (all in 2007/08 prices), with an increase of no more than RPI+1.75 per cent each year during the rest of the five-year period. These figures compare with prices proposed by BAA of £6.38 per passenger, with an annual increase of RPI+7.1 per cent.

In addition to its conclusions on airport charges, the CC also found that Stansted Airport had acted against the public interest in the period since the last reference to the CC by failing to consult adequately with airlines on the development of the airport and its capital expenditure plans; by failing to manage as effectively as possible the security queuing process; and by failing to offer appropriate landing charges for larger cargo aircraft.

The CC is, therefore, recommending that the CAA requires BAA to improve the consultation process; introduce a service quality rebate scheme, similar to those at Heathrow and Gatwick, which will impose financial penalties on BAA if it fails to meet agreed standards; and offer off-peak discounts on landing charges for the largest cargo aircraft.

The CAA will now consider the CC's recommendations, before carrying out a further round of consultation and announcing its final decision in March 2009.

CC Deputy Chairman Christopher Clarke, Chairman of the Stansted inquiry and also of the CC's market investigation into BAA airports, said:

> We believe our recommendations will provide the necessary incentives for BAA to meet existing and future customers' needs by operating efficiently and by continuing to develop the airport.

[1]This is equivalent to £6.56 in 2008/09 prices.

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Our inquiry has not been straightforward. It has been conducted against a background of uncertain and deteriorating economic and financial conditions, which, in particular, have made it difficult to forecast passenger numbers for the next five years and to assess the appropriate level of return which the airport should be allowed to earn. The CAA will need to keep these issues under review before making its final determination in March next year. Also, our terms of reference from the CAA were unusually broad, and, for a number of reasons, less preparatory work had been undertaken.

The reference was delayed by more than a year while consideration was given to the CAA's proposal to the Department for Transport (DfT) that Stansted should be de-designated, which would have removed the need for price control regulation. Following the DfT's decision not to de-designate, the CAA's terms of reference to us requested advice on the level of competition at Stansted, both currently and throughout the five years, as well as on the appropriate form of price regulation. Consistent with its own assessment of competition at Stansted, the CAA proposed a precautionary approach to price regulation, suggesting that reliance should be placed on market forces, with a cap set as a safeguard. This is in contrast to the current approach which allows the airport a return on its regulatory asset base (RAB), which in March 2008 the CAA confirmed was still the appropriate approach for both Heathrow and Gatwick.

Whilst we considered a number of options for setting the price control, there were a number of factors which persuaded us that we should retain the current RAB-based method, appropriately adjusted for uncertainties over the capital expenditure programme. These included Stansted's strong competitive position, the practical difficulties in introducing significant changes in a limited timeframe and the current review of airport regulation by the DfT and by ourselves in our market investigation into all BAA's airports.

Another challenge has been to determine an appropriate capital expenditure programme, which is a key element in determining an appropriate price cap. 'Constructive engagement' between Stansted and its airline customers was short-lived, being terminated by the CAA at the end of 2005 due to lack of progress. We took the view that an airport's airline customers are generally in a much better position than the regulator to suggest what development is needed at the airport, even recognizing their self-interest. We therefore sought to rekindle discussions between BAA and the airlines with the encouraging result that agreement has been reached on the scope and phasing of almost the whole of the five-year capital expenditure programme for the airport's existing facilities. This is now forecast to cost £85 million (in 2007/08 prices) compared with the £239 million initially put forward by BAA. Many projects have been reduced in scale, some deferred until later and others removed altogether.

With regard to BAA's proposals for a new runway, terminal and associated facilities, which were expected by BAA to cost £1.1 billion over the five-year period (and £2.3 billion overall), BAA has agreed to our suggestion that, given the uncertainty surrounding this project, all

construction costs should be excluded at this stage but, should circumstances change in the course of the quinquennium (for example, if planning approval is granted), it would be open to BAA to seek an interim determination by the CAA. The CAA would then seek to re-set the price caps for the remainder of the quinquennium in the light of the information available at that time. We are therefore recommending that only £40 million (in 2007/08 prices) should be included in the capex forecasts, which represents BAA's anticipated expenditure to the point of gaining planning approval. We would hope that the progress we've made in bringing the parties together and our preliminary assessment of BAA's spending plans for the second runway project will assist in this process.

We are recommending a cost of capital, which determines the rate of return allowed on new and existing assets at Stansted, of 7.1 per cent in real pre-tax terms, which compares with 6.5 per cent at Gatwick and 6.2 per cent at Heathrow.

In addition to our conclusions on airport charges, we have found that Stansted has acted against the public interest in three important areas. The CAA is required to act on these and we are therefore recommending that the CAA requires BAA to improve its process of consultation with the airlines on the development of the airport; to introduce a service quality rebate scheme, similar to the schemes in operation at Heathrow and Gatwick; and to offer the largest aircraft operating at the airport an off-peak discount for landing charges, as is available for all other aircraft.

Notes for editors

1. The CC is an independent public body, which carries out investigations into mergers, markets and the regulated industries.

2. Enquiries should be directed to Rory Taylor on 020 7271 0242 or rory.taylor@cc.gsi.gov.uk.

3. The Airports Act 1986 requires the CAA to set maximum limits on airport charges at airports designated for this purpose by the Secretary of State for Transport. These airports are: Heathrow, Gatwick and Stansted. Before setting new controls, the CAA is required by the Airports Act to refer the price controls for each airport to the CC, which then conducts its own review lasting around six months before reporting back to the CAA. The CAA must have regard to the CC's report, but the CAA is the final decision-making body with respect to price controls.

4. In March 2007, the CAA extended the current price controls on Stansted Airport by 12 months, so that they will expire on 31 March 2009. This extension was implemented in order to allow time for the DfT to decide whether Stansted and Manchester airports should continue to be designated for price control by the CAA. The DfT decided that Stansted should continue to be subject to price controls.

5. BAA plans to expand Stansted's capacity over the next decade with two large projects: Stansted Generation 1 (SG1), which consists of work to increase Stansted's capacity to 35 million passengers a year by 2015/16 (approval was recently granted for this development by the Government lifting existing planning restrictions) and Stansted

Generation 2 (SG2), which involves the construction of a new runway and terminal at Stansted. A public inquiry on this development is expected to start in spring 2009.

6. The price review for Stansted Airport is separate from the CC's ongoing market investigation into BAA airports. The CC has assessed the price control options on the basis of the current ownership structure and system of regulation, rather than by anticipating any changes that may result in the future, either from the market investigation or from the DfT's review of the airports' regulatory system. The Secretary of State for Transport has stated that the current basis of price controls at Stansted from 1 April 2009 will remain in force for the duration of the five-year price control period.

7. The members of the Stansted price control review group were Christopher Clarke (Group Chairman and CC Deputy Chairman), Laura Carstensen, Dr John Collings, Professor Jonathan Haskel, Richard Holroyd, Professor Peter Moizer and Professor Sudi Sudarsanam. The Inquiry Director was Andrew Wright.

8. For further information on the inquiry go to: www.competition-commission.org.uk/inquiries/ref2008/stansted/index.htm.