

**Airport Regulation
Economic Regulation of Stansted Airport 2009-2014
CAA Decision**

13 March 2009

***Civil Aviation Authority
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Summary

1. The CAA sets out in this document its decisions for the setting of new price controls at Stansted airport for the five years from 1 April 2009 to 31 March 2014 (the period known as Q5 or the fifth quinquennium), and for addressing three public interest findings made by the Competition Commission in relation to service quality, user consultation and the structure of airport charges. In doing so, the CAA has had regard to the Commission's report, its analysis, findings and recommendations, and to the views and evidence received following the CAA's consultation on its proposals, issued in December 2008.

Price controls

2. Against this background, the CAA has decided to retain its proposed dual approach to setting the Stansted Q5 price control, namely:
 - to assess the reasonableness of the Commission's individual 'building blocks' of its proposed price control, including in the light of new information received since the Commission's 23 October 2008 report (which has been updated in the light of responses, and new information); and
 - to assess the resulting price caps against the CAA's statutory objectives, recognising that these objectives may in future best be met by facilitating competition between airports (which has been updated in the light of responses, and new information).
3. The CAA is aware that this dual approach to setting the price control builds upon – and therefore might be presented as a departure from – the Competition Commission's recommendation to set the Stansted Q5 price control by reference to a RAB-based approach. The CAA nevertheless believes its approach to be justified for two principal reasons: the unusual degree of market uncertainty and the importance of taking into account the effects of the Q5 price control on outcomes in both Q5 and beyond.
4. This particular price control review decision is being made amid considerable change, currently and prospectively, in the regulatory and market landscape. Moreover, since December 2008, that uncertainty has intensified, not least as a consequence of the deepening of the economic recession. This uncertainty means that it is very difficult, in practice, to arrive at estimates of individual building blocks with the degree of accuracy normally associated with regulatory authorities applying this form of regulation. As a consequence, the degree to which it is possible – and reasonable against the CAA's statutory objectives – to place reliance solely on such estimates is questionable.
5. There is also the potential for the Stansted Q5 price control (and the method upon which it is based) to influence or distort outcomes beyond Q5, e.g. as a

result of the effect the decision may have on major investment decisions. It seems clear that the CAA's statutory objectives require it to take those long term implications into account, and therefore – in contrast with the Commission, which stated in its review that it '... was only concerned with the specific period of Q5' and that the prospects for long-term competition '... were not relevant for the Stansted review' – the CAA has decided explicitly to consider them.

6. In terms of the detailed price control design, the CAA has decided to set the Stansted price control on a stand-alone basis, i.e. by reference to the costs, assets and market circumstances at Stansted airport alone. In doing so, the CAA has had regard to the costs, assets and market circumstances faced by the whole airport, i.e. the aeronautical and commercial elements of the airport combined, often referred to as the 'single till'. The CAA has also set the detailed aspects of the design of the price control in accordance with the recommendations of the Competition Commission, which were very largely endorsed by all parties in consultation.
7. The CAA has re-assessed the individual 'building blocks' which comprise the Commission's recommended price caps, in light of the challenges from interested parties to the CAA's and the Commission's regulatory judgements on a number of issues, and in light of the latest evidence on broader economic developments.
8. Despite the relatively short period of time since the Commission reached its conclusions (and even shorter since the CAA issued its proposals for consultation in December 2008) the economic situation has continued to deteriorate. The CAA has undertaken some modelling to estimate the potential quantitative impacts to projected costs and revenues. This modelling suggests that the macro-economic downturn would likely:
 - put upward pressure on the cost of capital;
 - put downward pressure on commercial revenues; and
 - reduce the base of passenger and non-passenger traffic from which allowed revenues would be assumed to be recovered,

and that these effects would significantly outweigh the impact of taking into account more up-to-date information on the RPI. This picture does not change materially even if the allowed return on the whole of the forecast £40 million associated with preliminary expenditure were to be disallowed. It follows that were a 'building block' price control to be set by making adjustments for the new evidence and analysis that has come to light since the Commission conducted its analysis and made its recommendations (in the relatively simplistic way described above), it could be argued that such a

price control would be higher – perhaps significantly so - than that proposed by the Commission¹.

9. However, it is not clear that the CAA can automatically infer from these results that a regulatory authority choosing to set a price control based on ‘building blocks’ would necessarily decide – in the light of all of the available evidence – to revise the price control upwards. For the same reason, it is not clear whether the Competition Commission – were it hypothetically able to provide up-to-date recommendations to the CAA – would choose to recommend a looser price cap than it proposed in October 2008. There are several reasons for this:
- first, the analysis is based on scenarios that are illustrative only, and qualified. Selecting different scenarios, attaching different relative probabilities to them, and considering second order interactions between them might well have delivered different results, which might have different – possibly less marked – consequences for a ‘building block’ price control;
 - second, there is a high degree of uncertainty around the effects that new information and evidence would have on individual building block assumptions. This uncertainty – which stems partly from the fact that new evidence has emerged in the relatively short period since the Commission reported to the CAA – might itself argue against fully reflecting in a revised building block price control the effects resulting from the latest information and evidence;
 - third, it also seems reasonable to suppose that the Commission – in arriving at its October 2008 recommendations – would have been conscious of the need to apply price controls that would be resilient to a range of different outturn scenarios. The CAA notes, for example, that the Commission, despite reaching its conclusions in the midst of the economic downturn, did not suggest that the CAA continue to keep assumptions about commercial revenues under review;
 - fourth, even if the view was taken that the new evidence, and updated ‘building block’ assumptions, implied that the revenues that Stansted should be permitted to recover should be increased, a regulatory authority applying a RAB-based price control approach with reference to the duties set out in section 39 of the Airports Act, might not choose mechanistically to loosen the price control for the forthcoming five year period. Rather, a regulatory authority, in these circumstances, might instead decide that it would be more appropriate to propose the deferral of revenue to a future period, especially if that regulator faced evidence suggesting that the regulated company might be unable to

¹ In referring to the price control proposed by the Commission, the CAA is referring to the Commission’s recommendations after adjusting for the omission of non-passenger revenues, i.e. the allowed revenues implicit in the CAA’s December 2008 proposed price control.

charge up to the level of the price control at the level of traffic assumed (as appears currently to be the case with Stansted). Indeed, this sort of approach was recommended by the Commission (and subsequently adopted by the CAA) in establishing the Stansted Q4 price control; and

- more generally, it is possible that a regulatory authority might – in these circumstances – place weight on the fact that a mechanism exists within the Airports Act for the airport operator to request that the CAA consider amending the price cap, thereby providing a ‘safety valve’ in the event that the price control proved in due course to be set at too tight a level such that it needed to be modified prior to the next periodic price control review.
10. For these reasons, the CAA considers that it is not clear that a regulatory authority applying a ‘building block’ price control would necessarily adjust the Commission’s price profile to reflect new information on the individual cost, revenue and traffic building blocks. Accordingly, the CAA continues to consider that the price caps as proposed in its December proposals and reflecting the Commission’s recommendations adjusted specifically to distinguish between price caps on passenger and non-passenger flights (as set out in Table 1 below) fall within the range of price caps that could be reasonably recommended by a regulatory authority applying a ‘building block’ methodology against the objectives set out under section 39 of the Airports Act.

Table 1 Price controls for Stansted Airport, 1 April 2009-31 March 2014

Passenger flights:					
Price cap £/passenger	2009/10	2010/11	2011/12	2012/13	2013/14
2009/10 prices	6.53	6.53	6.63	6.74	6.85
Increase in price cap: retail price inflation plus X%		RPI+0%	RPI+1.63%	RPI+1.63%	RPI+1.63%
Non-passenger flights:					
Airport charges for landing and parking to be no higher than the equivalent charges for a comparable passenger aircraft					

11. In reaching this conclusion, the CAA has not itself assessed the merits, timing, costs and benefits of BAA’s plans for a second runway at Stansted, which proposals are currently subject to a planning inquiry under the Town and Country Planning Act 1990. The CAA agrees with the Commission’s conclusion that, given the current uncertainties surrounding the timing of this project, the substantive costs of construction and benefits of a second runway do not need to be factored into the Q5 price controls at this stage. The CAA also considers that, in light of recent developments regarding weakening traffic demand and the prospect of some delay to the planning inquiry, the scale and timing is now more uncertain of any planning and development costs for a second runway project in the coming five years.
12. The CAA notes that the price cap is the maximum revenue per passenger which the airport can levy through airport charges, rather than a mandatory

price increase. The price cap does not preclude the airport setting published charges below the cap and/or the airport and airlines negotiating prices below the published charges – both of which have occurred at Stansted in recent years.

13. The CAA has also considered the extent to which the arguments and analysis put forward by respondents and the available new market evidence affects the assessment that the CAA undertook in its December 2008 proposals of the proposed price cap profile against the CAA's statutory objectives. In doing so, it compared the proposed price cap against the competitive price level, using measures of replacement and incremental cost, so as to ensure that competing airports – and the development of competition – are not adversely affected.
14. It appears that the impact of new information does not significantly affect the CAA's previous assessment. The available information on the appropriate cost of capital might increase measures of forward-looking cost, but this effect is likely to be offset by the impact of additional downside risk to traffic. This additional risk, should it crystallise, would be expected to put downward pressure on the short-term competitive price level and would tend to reduce the speed with which the price cap might need to move toward forward-looking measures of cost.
15. Furthermore, whilst new information suggests that there might be additional downside risk faced by the airport operator, this reflects underlying market pressures at the airport. By contrast, a mechanistic application of a 'building block' methodology could have resulted in an upward adjustment to the price cap in the very period in which the market might be expected to put downward pressure on prices paid by airlines and passengers at Stansted.
16. In addition, the CAA is mindful of the adverse incentive effects that an expectation of continued RAB-based regulation might have on investment decisions and the ability of the airport operator and airlines to reach agreement on how best to develop the airport.
17. The CAA therefore considers that the assessment presented in the December 2008 proposals document remains appropriate and that, in light of the evidence available now and subject to the additional measures discussed below, the price cap profile proposed is consistent with the CAA's statutory duties.
18. The CAA remains of the view that, by signalling now that there should be no presumption that a RAB-based approach would apply in future, the adverse consequences of this approach to regulation can be mitigated. This statement is also supported by the cross-check that the CAA has performed which ensures that the Q5 proposed price cap does not undermine the credibility of adopting alternative price control approaches in future and by

the CAA's future work programme, which will include further work to develop alternative regulatory approaches.

19. As a consequence, the CAA hereby confirms that:

- there is a dual rationale for the CAA arriving at the profile set out above; that 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; and that had the CAA not been able to satisfy itself on this latter point, the CAA might have had to consider adopting a price cap that would have facilitated competition between airports;
- there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted airport, whether or not the modification occurred 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); and
- the CAA will initiate a work programme to develop further its thinking on alternative approaches to price control regulation that facilitate – rather than distort – competition. The CAA currently expects the scope of this work to include:
 - i. periodically assessing the degree of competition between airports;
 - ii. identifying and assessing alternative approaches to price regulation, as competition intensifies;
 - iii. carrying out work on estimating forward-looking costs of airport development (including, but not necessarily limited to, Long Run Average Incremental Costs) that could serve to inform judgements about price controls in future; and
 - iv. considering how such alternative approaches to setting price controls would best be applied in practice.

The CAA expects the precise scope and content of the work programme to be the subject of a consultation that the CAA would expect to launch later this year.

20. The CAA, therefore, has decided that the price control on Stansted airport should be the same as it proposed in December 2008, as set out in Table 1, and is imposing the price control conditions in Annex B.

Public interest conditions

21. The Commission found that Stansted Airport Limited (STAL) had operated against the public interest in three regards since the previous CAA reference: in its approach to consultation with airline users on airport development; in its provision of airport services of adequate quality; and in the structure of its airport charge tariff for the largest category of aircraft. In each case, the Commission made recommendations as to the conditions which the CAA might put in place to prevent such actions against the public interest from recurring.
22. The CAA has decided to adopt, in each case, the conditions in accord with those the Commission has recommended. The CAA's decisions are thus:
- On consultation, to require that STAL adhere to the CAA's specification for the content and conduct of consultation (described as an 'information protocol'), and to seek to resolve any outstanding differences with airline users on such consultation via an independent consultation facilitator appointed by the CAA.
 - On service quality, to impose a set of service performance standards and rebates, under which the airport operator would reimburse airlines up to 7 per cent of airport charges where the airport's service performance falls short of the defined standards. The CAA has decided to focus some two-thirds of the financial incentives on consistent delivery of efficient passenger security processing, in line with the joint proposals of Stansted airlines and the airport operator.
 - On the structure of airport charges, to require that STAL offer off-peak discounts to aircraft in the largest weight-band on a comparable basis to the off-peak discounts offered to the next weight category of aircraft.
23. The CAA welcomes the positive engagement between the airport operator and its airline users in recent months on airport operations and service performance. This has led to a broad consensus on the scope and specifics of the regulatory measures, now implemented by the CAA, to incentivise consistently better service performance by the airport, to the benefit of passengers and airlines. The CAA looks forward to continuing this positive engagement as it implements measures to facilitate consultation on airport development and investment in the coming years.

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1. Introduction

Purpose of this document

- 1.1 This document sets out the CAA's final decisions on the new price controls at Stansted airport for the five years from 1 April 2009 to 31 March 2014 (the fifth quinquennium of price controls, known as Q5) and for addressing three public interest findings made by the Competition Commission in relation to service quality, consultation and the structure of Stansted airport's charges. The CAA is also extending and modifying conditions imposed to remedy previous public interest findings by the Competition Commission.

Background

- 1.2 The Airports Act 1986 (the 'Act') requires the CAA to impose in relation to airports designated by the Secretary of State for this purpose:

'such conditions as to airport charges...as the CAA considers appropriate for regulating the maximum amounts that may be levied by the airport operator by way of airport charges at the airport during the [next] period of five years...'

- 1.3 At the end of each five-year period, the CAA must make such modifications in the conditions as it thinks appropriate for regulating the maximum amounts over the next five years. Before imposing price control conditions, or making modifications to such conditions, the CAA must make a reference to the Competition Commission. The Competition Commission makes recommendations to the CAA as to what the maximum amounts capable of being levied by the airport operator by way of airport charges should be during the next period of five years. The Competition Commission also determines whether an airport has, since the previous reference, pursued a course of conduct in its airport related activities that has operated, or might be expected to operate, against the public interest. If the Competition Commission identifies such a course of conduct, it must go on to determine whether the effects adverse to the public interest which that course of conduct has had, or might be expected to have, could be remedied or prevented by the imposition of any conditions, or the modification of any conditions currently in force, in relation to the airport.
- 1.4 The CAA duly referred Stansted Airport to the Competition Commission on 29 April 2008 in relation to the five-year period from 1 April 2009 to 31 March 2014. The CAA's reference asked the Competition Commission to investigate and report on:
- (a) what are the maximum amounts that should be capable of being levied by Stansted Airport Ltd by way of airport charges at Stansted Airport during the period of five years beginning on 1 April 2009;

- (b) whether Stansted Airport Ltd had at any time during the period between 28 February 2002 (the date of the previous reference) and 29 April 2008 pursued:
- i. in relation to any airport charges levied by it at Stansted airport, or
 - ii. in relation to any operational activities carried on by it and relating to Stansted airport, or
 - iii. in relation to the granting of a right by virtue of which any operational activities relating to Stansted airport may be carried on by any other person or persons, a course of conduct which has operated or might be expected to operate against the public interest;
- (c) whether any associated company of Stansted Airport Ltd had at any time between 28 February 2002 and 29 April 2008 pursued:
- i. in relation to any operational activities carried on by it and relating to Stansted airport, or
 - ii. in relation to the granting of a right by virtue of which any operational activities relating to Stansted airport may be carried on by any other person or persons, a course of conduct which has operated or might be expected to operate against the public interest; and
- (d) if so, whether the effects adverse to the public interest which the course of conduct that falls within (b) or (c) above has had, or might be expected to have, could be remedied or prevented by the imposition of any conditions in relation to Stansted airport or by the modification of any conditions already in force in relation to Stansted airport.

1.5 The CAA published the reference on its website² on 29 April 2008. The CAA also provided to the Competition Commission with the reference a document setting out its own assessment of a number of aspects of determining the price control conditions³. This document laid out a wide range of potential regulatory approaches, relevant evidence, and the CAA's preliminary assessment of how each of these might address the particular challenges of economic regulation of Stansted, in particular the interaction between competition and regulation in delivering services and facilities for airport users, and the impact of regulation on incentives to invest in new capacity. This document took into account a range of evidence and analysis, including

² www.caa.co.uk

³ Price control review – CAA reference to the Competition Commission for Stansted Airport, CAA, April 2008

the CAA's assessment of responses to previous consultation documents, such as the CAA's earlier consultation on the framework and options for the economic regulation of Stansted airport⁴. The CAA provided this information in accordance with section 44(2) of the Act.

- 1.6 The CAA's reference asked the Competition Commission to report within six months. The Competition Commission reported to the CAA on 23 October 2008⁵. In accordance with section 45(6)(a) of the Act, the CAA sent copies of the report to the Department for Transport and BAA⁶. The CAA published the report on its website on 4 November 2008 after making the excisions directed by the Secretary of State under section 45(7) of the Act. The Competition Commission's report has also been published by TSO and is available on the Competition Commission's website (www.competition-commission.org.uk). For ease of reference, a summary of the Competition Commission's conclusions and recommendations is at Annex A. These should be read in the context of the Competition Commission's report as a whole.
- 1.7 Following receipt of a Competition Commission report recommending the maximum amounts that may be levied by an airport operator by way of airport charges at an airport, under section 46(1) of the Act the CAA must impose price control conditions or modify price control conditions already in force. Further, where the Competition Commission finds that the airport operator has pursued a course of conduct adverse to the public interest, under section 46(2), the CAA must impose conditions, or make such modifications to conditions already in force, as it considers appropriate to remedy or prevent those adverse effects where the Competition Commission makes a public interest finding. In imposing charges conditions, the CAA must have regard to the Competition Commission's recommendations. In imposing conditions relating to public interest findings, the CAA must have regard to the remedies the Competition Commission has specified in its report. The CAA has to publish notice of the conditions (or modifications to existing conditions) it intends to impose and, where these differ from the Competition Commission's recommendations, give the reasons for such differences.
- 1.8 On 9 December 2008, the CAA published a document setting out and explaining its proposals for conditions in respect of airport charges at Stansted airport for the period of five years from 1 April 2009 to 31 March 2014 and in respect of the public interest findings made by the Competition Commission on service standards, consultation and the structure of

⁴ Price control review – consultation on the framework and options for the economic regulation of Stansted airport, CAA, January 2008

⁵ This report is referred to in various footnotes throughout this decision document as CC October 2008.

⁶ The copy of the report sent to BAA excluded certain material in relation to third parties in accordance with section 45(4A) to (4D) of the Act.

charges⁷. The CAA also addressed in the document a number of other issues that the Competition Commission had raised in its report. The document was published for the purposes of publishing notice of the conditions or modifications the CAA intended to impose pursuant to regulation 12 of the Civil Aviation Authority (Economic Regulation of Airports) Regulations 1986.

- 1.9 The CAA invited written representations on its proposals by 3 February 2009. In addition, the CAA described and explained its proposals at an industry seminar held on 16 December 2008. It also held oral hearings on 9 February 2009. The CAA received written responses to its proposals from the AUC, BAA, Ryanair, the Stansted Airport Consultative Committee and from a member of the public, Mr P Robertson. The non-confidential submissions were published on the CAA's website. BAA and the Stansted Airport Consultative Committee attended the oral hearings on 9 February 2009. Transcripts of those hearings will be published on the CAA's website, again subject to confidentiality constraints. The CAA has carefully considered all the representations that were made to it both in response to its December 2008 proposals and at, and following, the oral hearings by those who made oral representations⁸.
- 1.10 The CAA is required by section 39 of the Act to perform its economic regulatory functions under the Act in the manner which it considers is best calculated:
- to further the reasonable interest of users of airports within the UK, with users defined to encompass both airlines and passengers;
 - to promote the efficient, economic and profitable operation of such airports;
 - to encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and
 - to impose the minimum restrictions that are consistent with the performance by the CAA of those functions.
- 1.11 In performing its economic regulatory functions the CAA must also take into account such of the UK's international obligations as have been notified to it by the Secretary of State. These obligations are found in:
- Article 15 of the Convention on Civil Aviation (Chicago Convention) 1944;

⁷ This report is referred to in various footnotes throughout this decision document as CAA December 2008.

⁸ At the oral hearings BAA and the Stansted ACC each agreed to provide further specific evidence arising from points made at the hearings. These further representations have also been published on the CAA's website subject to confidentiality constraints.

- provisions relevant to the imposition of charges in the 2007 Agreement on Air Transport with the United States of America between the European Union and the US Government (which took effect on 30 March 2008); and
 - provisions relevant to the imposition of charges in any other of the UK's Bilateral Air Service Agreements.
- 1.12 The CAA has taken the decisions in this document in the manner which it considers is best calculated to achieve its statutory objectives described above and has had regard to the recommendations made by and the conditions and modifications specified by the Competition Commission in its report as it is required to do by section 46(4) of the Act. In accordance with section 46(5) of the Act, this document explains where the CAA has not adopted the recommendations made by the Competition Commission and states the reasons for those departures. In reaching the decisions in this document, the CAA has taken into account all available information and evidence that is relevant to those decisions.
- 1.13 The CAA has also taken into account the principles of better regulation that are now enshrined in the Legislative and Regulatory Reform Act 2006.
- 1.14 The decisions of the CAA in this document were taken by a panel of members comprising Dr Harry Bush, Mr Jim Keohane and Mr Roger Mountford, appointed for this purpose by the CAA Board.
- 1.15 This document constitutes a statement by the CAA as required by section 46(5) of the Act.

Approach to setting the level of the price control

The CAA's December 2008 proposals

- 1.16 The CAA's December 2008 price control proposals comprised two steps:
- an assessment of the reasonableness of the Competition Commission's assumptions regarding the individual 'building blocks' of its proposed price control, including in the light of new information received since the Commission's 23 October 2008 report; and
 - an assessment of the resulting price caps against the CAA's statutory objectives, recognising that these objectives may in future best be met by facilitating competition between airports.
- 1.17 The CAA thus adopted a dual rationale for the price control profile, with the price control proposals being a product of both the 'building block' analysis that had been carried out by the Commission and the CAA's assessment that the resulting price control profile was consistent with the development of more effective competition between airports over time.

- 1.18 In making its assessment of the reasonableness of individual 'building blocks', the CAA did not seek to arrive at pin-point figures. Instead, the CAA explained that it did not believe that it would be feasible to make assumptions that would prove to be accurate over the full Q5 period, given the economic outlook at the time, and the market circumstances faced by Stansted. As a consequence, the CAA determined that the most appropriate course was to consider whether the assumptions reached by the Commission were within the range of reasonable assumptions that could be adopted by a regulatory authority were it to carry out a 'building block' calculation in accordance with the CAA's statutory objectives. And – with the exception of an adjustment to take into account airport charge revenues from non-passenger flights – the CAA considered that there was no clear-cut case on that basis for adjusting the Commission's price profile to reflect new information on the individual cost, revenue and traffic 'building blocks'.
- 1.19 The CAA cross-checked the resulting price controls to satisfy itself that it would be consistent with its statutory objectives. The CAA satisfied itself that the resulting level of the price caps was consistent with its statutory objectives. However, it identified a risk that incentives created by RAB-based or 'building block') regulation could have substantial adverse effects on the behaviour of Stansted airport and its airline users, which could distort competition to the detriment of users generally. The CAA proposed to address this risk:
- first, by clarifying that there was a dual rationale for the CAA arriving at the profile (as described above), including making clear that had the CAA not been able to satisfy itself that the resulting price control profile was consistent with the development of more effective competition between airports over time, the CAA might have had to consider adopting a price cap that would have facilitated competition between airports;
 - second, by stating that there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted airport (whether a re-opening of the Q5 price cap within the quinquennium or any future price cap set at the end of Q5 for a subsequent period); and
 - third, by putting in place a work programme to develop further its thinking on alternative approaches to price control regulation that facilitate – rather than distort – competition.
- 1.20 By taking the steps outlined above, the CAA stated that it would expect to address the potential for substantial adverse effects to arise. However, in doing so, the CAA stated that it did not believe that it would be accurate to describe its proposed Q5 price cap as a RAB-based price control. This was principally because there could be no presumption that the Stansted RAB

would continue to form the basis of succeeding price controls, should any be applied.

- 1.21 The CAA considered that such a regulatory approach would provide a more stable framework within which to bring forward investment projects, thereby facilitating both the development of a more competitive airport market and efficient investment in capacity and service quality. It considered that a stable framework for investment was, ultimately, in the interests of airports and their users.

Consultation responses

- 1.22 BAA commented that, despite the CAA's careful words, the CAA's proposals seemed to BAA to be clearly based on the RAB approach. BAA also commented that the CAA had not put forward a convincing argument as to why its December 2008 proposals were not reflective of a standard RAB-based approach.
- 1.23 The SACC also argued that the CAA had a 'duty' to revisit certain of the 'building blocks':
- in the light of current market circumstances;
 - where the Competition Commission simply ran out of time to investigate them in detail; and
 - where the recommendations appear contradictory, out of line with the CAA's regulatory objectives and/or past decisions, and/or out of line with the Commission's findings on public interest.
- 1.24 The SACC went on to say that it believed that this work should already be underway. In this context, the SACC said it considered it particularly relevant that the Commission had clearly rejected the CAA's suggested alternative approaches to regulation. It also believed that it would be entirely inappropriate for the CAA to seek to hide behind some notion that it was moving towards a safeguard cap during Q5 as a basis for its decision not properly to scrutinise issues explicitly referred back to it for consideration by the Commission or to otherwise resolve outstanding issues, which are set out below.
- 1.25 Ryanair echoed this view. In Ryanair's view, the CAA had failed to carry out a 'proper' analysis of the BAA's costs and had 'dumped' this responsibility on the Commission. Ryanair considered that the CAA must now properly address the issues regarding BAA's costs that had been left unresolved (which had been identified in the SACC's submission).

Analysis of respondents' views

- 1.26 The CAA has first considered BAA's view that its proposals are clearly based on the RAB approach. For a price control to be clearly based on a RAB approach – in the same way that the CAA applied the RAB-based approach to the regulation of Heathrow and Gatwick airports last year – single estimates of each individual cost, revenue and traffic 'building block' would be made, and a price control set primarily by reference to those 'building blocks'. That is not the approach that underpinned the CAA's December 2008 proposals, and it is not the approach adopted in reaching the decision set out in this document, which also involves an explicit, supplementary test to ensure that the resulting price profile (and associated incentives) on Stansted airport (and other airports) is best calculated to meet the CAA's statutory duties. The CAA therefore does not agree with BAA that its proposals can accurately be described primarily as a RAB-based price control, without further qualification.
- 1.27 The CAA has also considered carefully SACC's and Ryanair's call for the CAA to undertake more detailed scrutiny and analysis of individual 'building blocks':
- in the light of current market circumstances;
 - where the Competition Commission simply ran out of time to investigate them in detail; and
 - where the recommendations appear contradictory, out of line with the CAA's regulatory objectives and/or past decisions, and/or out of line with the Commission's findings on public interest.
- 1.28 The CAA agrees with the SACC and Ryanair that market circumstances have continued to change significantly since the CAA published its December 2008 proposals. Moreover, the CAA agrees that it is appropriate to take changing market circumstances into account. But there is a difference between taking into account the fact that market circumstances (both currently and prospectively) are very volatile on the one hand, and striving to arrive at single assumptions for individual 'building blocks', including taking into account latest market information, on the other. In the CAA's view, the very fact that market circumstances are currently so volatile – as a result of uncertainty as to the degree of competition the airport will face in Q5 (including the likely competitive response of Gatwick and Luton airports), and the uncertainty around the economy and its related impact on costs, revenues and traffic – itself conditions the extent to which it is appropriate to rely simply on individual 'building block' assumptions made at any one point in time. It suggests that it is not appropriate to rely exclusively on assumptions about individual cost, revenue and traffic 'building blocks', given the significant risk of error. The Competition Commission itself recognised the high degree of uncertainty around some of the 'building blocks'.

- 1.29 As the CAA noted in its December 2008 proposals, there is also the potential for the Stansted Q5 price control (and the method upon which it is based) to influence or distort outcomes beyond Q5, e.g. as a result of the effect the decision may have on major investment decisions. It seems clear that the CAA's statutory objectives require it to take those long term implications into account, and therefore – in contrast with the Commission, which stated in its review that it '... was only concerned with the specific period of Q5' and that the prospects for long-term competition '... were not relevant for the Stansted review' – the CAA has decided explicitly to consider them.
- 1.30 Against this background, while the CAA acknowledges that some consideration can and should be given to the effect of recent developments on cost, revenue and traffic 'building blocks' (as the CAA does in chapter 3 of this document), it is the CAA's view that the market circumstances suggest that it is more – not less – important for the CAA to have regard not only to individual cost, revenue and traffic 'building blocks', but also to the likely short and long term impact of any resulting price profile against its statutory duties.
- 1.31 The CAA does not agree with the claim made by SACC that the Commission ran out of time. Had the Commission been short of time, the Commission might have been expected to take the full six month period to report back to the CAA with its recommendations, or – should the Commission have deemed it necessary – to request an extension. In fact, the Commission delivered its report to the CAA seven days before the six-month deadline, and at no point suggested that time was inadequate.
- 1.32 The CAA has considered the specific claims that the CAA's proposals appear contradictory, out of line with the CAA's regulatory objectives and/or past decisions. Moreover, the CAA has reviewed and updated its assessment of its proposals against its statutory duties, in light of the responses received. This assessment is set out in chapter 4.
- 1.33 The SACC went on to say that the CAA's scrutiny should have commenced before the SACC had submitted its reply. The CAA does not accept this. It seems to the CAA proportionate and reasonable to wait until the receipt of consultation responses before undertaking further review, provided doing so does not prejudice the ability to respond appropriately to consultation responses. In this case, the CAA is satisfied that it has not done so.

CAA's decision

- 1.34 Against this background, the CAA has decided to retain its proposed dual approach to setting the Stansted Q5 price control, namely:
- to assess the reasonableness of the Commission's individual 'building blocks' of its proposed price control, including in the light of new information received since the Commission's 23 October 2008 report (which has been updated in the light of responses, and new

information, in chapter 3); and

- to assess the resulting price caps against the CAA's statutory objectives, recognising that these objectives may in future best be met by facilitating competition between airports (which has been updated in the light of responses, and new information, in chapter 4).

1.35 The CAA is aware that this dual approach to setting the price control builds upon – and therefore might be presented as a departure from – the Competition Commission's recommendation to set the Stansted Q5 price control by reference to a RAB-based approach. The CAA nevertheless believes its approach to be justified for two principal reasons: the unusual degree of market uncertainty and the importance of taking into account the effects of the Q5 price control on outcomes in both Q5 and beyond.

1.36 This particular price control review decision is being made amid considerable change, currently and prospectively, in the regulatory and market landscape. Moreover, since December 2008, that uncertainty has intensified, not least as a consequence of the deepening of the economic recession. This uncertainty means that it is very difficult, in practice, to arrive at estimates of individual building blocks with the degree of accuracy normally associated with regulatory authorities applying this form of regulation. As a consequence, the degree to which it is possible – and reasonable against the CAA's statutory objectives – to place reliance solely on such estimates is questionable.

1.37 There is also the potential for the Stansted Q5 price control (and the method upon which it is based) to influence or distort outcomes beyond Q5, e.g. as a result of the effect the decision may have on major investment decisions. It seems clear that the CAA's statutory objectives require it to take those long term implications into account, and therefore – in contrast with the Commission, which stated in its review that it '... was only concerned with the specific period of Q5' and that the prospects for long-term competition '... were not relevant for the Stansted review' – the CAA has decided explicitly to consider them.

1.38 A summary of the CAA's price control decision is contained in chapter 5.

2. Price control framework and design

Introduction

2.1 In this chapter, the CAA considers the views and evidence submitted during the course of consultation on the CAA's proposals for the detailed price control framework and design. In light of these, the CAA sets out its decisions on these issues for the Q5 Stansted price control. These decisions are implemented by the CAA's price control conditions, set out in Annex B to this decision document.

CAA's December 2008 proposals

2.2 The CAA made the following proposals as to the framework of price control for Stansted during Q5:

- Stand-alone approach: the CAA agreed with the Commission's recommendation to continue to set price controls for Stansted on an individual airport basis (a stand-alone approach), and not across all three of BAA's designated London airports (a system approach).
- Single till: the CAA agreed with the Commission's recommendation that the maximum level of airport charges at Stansted in Q5 should continue to be set on a single till basis, which takes account of other revenues at the airport (e.g. retail and car parking) and associated costs, as opposed to a dual till basis, where airport charges are required to cover aeronautical costs without taking such revenues and costs into account.

2.3 The CAA made the following proposals as to the specific design of the price control for passenger flights at Stansted for the Q5 period:

- RPI-X: the CAA agreed with the Commission's recommendation to retain this incentive structure for the price cap, with changes in price caps determined by a combination of the change in the Retail Price Inflation index and the CAA's decision on an X factor for years 2 to 5 of the quinquennium.
- Volume risks: the CAA agreed with the Commission's recommendation to continue to set the price cap based on an average projected airport charge yield per passenger, with no subsequent adjustment to the price controls for outturn traffic volume.
- Discounts: the CAA agreed with the Commission's recommendation to continue to set the price cap on average airport charge revenue yield per passenger as implied by the airport's published tariff, and thereby without regard to any unpublished discounts that the airport operator might choose to grant its airline users.

- Revenue yield approach: the CAA agreed with the Commission's recommendation to continue to set the price cap on the basis of the revenue yield (i.e. calculated as a revenue per passenger) rather than as a 'tariff basket' (i.e. calculated as a weighted average of all of the elements of the airport charging structure where the weights are fixed prior to the relevant charging year).
- Correction term: the CAA agreed with the Commission's recommendation to adjust the specification of the correction factor, in order to recover, in year t+2, the absolute level of revenue (subject to two years' interest) of any over- or under-recovery, rather than the over- or under- recovery in yield per passenger (as currently applies in the Q4 price control).
- Carry forward of Accumulated Under Recovery from Q4 to Q5: the CAA agreed with the Commission's recommendation that there should be a break in the correction factor at Stansted at the end of Q4, with the calculation restarting from zero in the new quinquennium, and that there should thus be no carry-forward of correction for under-recovery of airport charge revenue between Q4 and Q5.
- Security: the CAA accepted the Commission's recommendations that the Q5 price control contain an S term that would provide for an uplift⁹ in price caps based on a percentage (90 per cent) of the additional costs of unanticipated increases in security requirements beyond a minimum threshold of £3.6 million. The CAA considered that the airport operator would have an incentive to achieve cost efficiency in its operations including the management of its security. The CAA considered that it would therefore be disproportionate to conduct a further review of the base cost of security against a test of efficiency that was established by consultants some years earlier and may therefore no longer provide a valid benchmark. The CAA would, however, expect to scrutinise any claim to establish that the additional costs arose from unforeseen mandated requirements and were no more than necessary fully to comply with those incremental requirements.
- Bonuses: the CAA agreed with the Commission's recommendation not to introduce any bonus term (for service performance above a specified standard) in the price control formula for Stansted in Q5, for two reasons: there was less need than at Heathrow and Gatwick for an incentive scheme intended to discover higher levels of service, when Stansted infrastructure was originally designed to a higher level

⁹ For the avoidance of doubt, the CAA preferred not to describe this as a pass-through as it believed this term may lead to misunderstanding. In the CAA's view, the S term is the basis for calculation of a discrete uplift in the control, rather than the basis for a continuing pass-through. It should also be noted that the adjustment mechanism would apply symmetrically to any reduction in security requirements leading to an unanticipated reduction in security processing costs.

of service than currently required by users; and the absence of prior foundation at Stansted of five years' operation of a service quality standards and rebates scheme, as at Heathrow and Gatwick.

- Capital expenditure triggers: the CAA agreed with the Commission's recommendation not to include any capital expenditure triggers in the Stansted price condition, which could have caused the airport operator to pay financial rebates to the airlines for the late and/or inadequate delivery of specified investment projects.

2.4 In respect of the specific design of the price control for non-passenger flights at Stansted for the Q5 period, the CAA agreed with the Commission's recommendation that non-passenger flights should continue to be excluded from the regulated yield, subject to the requirement that the charges applied to such flights (e.g. for landing) should be the same as for passenger aircraft.

2.5 In its December 2008 proposals, the CAA also made an adjustment to reconcile the Commission's recommendations of separate price caps for passenger and non-passenger flights with an overall revenue allowance; and proposed a public interest condition to remedy an adverse finding from the Commission on the structure of airport charges which affected the largest cargo aircraft

Consultation responses

2.6 The Air Transport Users Council (AUC) supported the CAA's proposal to set Stansted Airport charges on a stand alone basis, and using a single till approach.

2.7 Except as noted below, both the SACC and BAA agreed with each of the CAA's proposals for the framework and design of the Stansted price control. (No individual airline offered separate comment on these issues).

2.8 With regard to the mechanism for modification to the price cap on account of unanticipated security costs, the SACC disagreed with the CAA's proposal not to subject any security cost claims to a further efficiency review of the base costs. The SACC considered that the airport operator should have to demonstrate underlying efficiency in security operations before being allowed to claim additional airport charge revenues to cover additional security costs driven by external requirements. The SACC repeated its view that there were inefficiencies in security rostering at Stansted.

2.9 On a related issue, the SACC queried how the Q4 security claim, which BAA Stansted had submitted in 2007, had been dealt with.

CAA assessment and decision

2.10 With regard to the security costs mechanism, the CAA has considered afresh the arguments put forward by the SACC. The CAA notes the following:

- in proposing a 'building block' price cap, the Commission itself undertook extensive analysis of operating expenditure at Stansted and incorporated efficiency targets within its projections for Q5 costs. Such projections therefore already incorporate the Commission's assessment of the prospects for improving the efficiency of security and other operations. The SACC welcomed the Commission's rigorous scrutiny and expressed itself content with the Commission's assessment of the potential for productivity gains; and
- the CAA will undertake an efficiency scrutiny of any security cost that is claimed by the airport operator. Such a scrutiny would not extend to base costs as that would undermine the incentive effects of the price control. However, it would examine the efficient means by which the airport operator could realistically meet the new security requirements. In the course of such scrutiny, the CAA would expect to take into account any evidence on revealed efficiencies in the airport's existing security processing.

2.11 The CAA considers that the reasonable interests of users of airports within the UK and the efficient, economic and profitable operation of the airport would be appropriately addressed through the combination of the Commission's and the CAA's security cost scrutiny studies described above. The CAA has therefore decided to confirm its proposed security costs uplift mechanism, subject to the following clarification:

Before adjusting the price cap for any additional security costs claimed by the airport operator as necessary to fulfil new external security requirements, the CAA will undertake two tests:

- assessment of whether the additional requirements which had been cited as the driver of the proposed additional costs were in practice a new net additional burden on airport security operations; and
- assessment of whether the proposed additional costs were an efficient level of spending to deliver the additional requirements.

2.12 With regard to the SACC's query on the Q4 security costs claim under the current security costs uplift mechanism, the CAA notes that the S claim to which the SACC refers would have increased the price cap at Stansted in 2008/09 by 15p per passenger. The CAA audited and analysed BAA's October 2007 claim during autumn/winter 2007/08. This analysis identified some outstanding issues regarding staff headcount, overtime payments and the inclusion of media and IT costs. The CAA consulted airlines in January 2008 on the claim. The CAA did not follow through to a regulatory conclusion later in 2008 as Stansted Airport had already set its published charges for 2008/09 at levels more than 15p per passenger below the cap and so a CAA decision on the S claim would have had no impact on prices in the sixth year of the extended Q4 period. This analysis would have had some relevance to

Q5 if the CAA or the Commission had contemplated carrying over from Q4 to Q5 unused amounts under the correction factor, but the Commission recommended, and the CAA proposed in December 2008, no such carry over to Q5. Any work conducted on this matter would, therefore, have been nugatory.

- 2.13 With regard to all other price control design aspects, in light of the consensus support for the CAA's proposals, the CAA confirms that it has set the Stansted Q5 price control on the basis of the framework and design described in paragraphs 2.2 to 2.4 above, for the reasons set out in chapter 2 of the CAA's December 2008 proposals.
- 2.14 The CAA has incorporated all these framework and design factors into the specification of the Stansted price control in Annex B to this document.

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3. Assessment of proposed price caps in light of consultation and new evidence

Introduction

- 3.1 In this chapter, the CAA sets out its assessment of the analysis and evidence presented by the Competition Commission in support of its Q5 price cap recommendations, which in turn informed the CAA's own proposed price caps on which it consulted in the period December 2008 to February 2009. The CAA considers the views and evidence submitted during the course of this consultation. It also considers other relevant evidence which has emerged over this period, notably with respect to the UK macro-economy.
- 3.2 In line with the approach it adopted in its December 2008 proposals, the CAA has not sought to replicate the Commission's own analysis. Rather, the CAA has reassessed (in light of views and evidence in front of it) its own reasoned view on the appropriateness of the Commission's judgements in arriving at the component parts of the 'building block' calculation and resulting price caps, in light of the design of the price control mechanism proposed by the CAA (and considered in chapter 2). The CAA conducted this reassessment with a view to assessing whether the resulting price caps on passenger and non-passenger flights fall within the range of price caps that could reasonably be recommended by a regulatory authority applying a 'building block' methodology against the objectives set out under section 39 of the Airports Act.

CAA's December 2008 proposals

- 3.3 The CAA assessed the Commission's 'building block' price cap analysis and recommendations. In particular, it considered a number of issues which the Commission had identified might warrant further analysis by the CAA, either into the detail of an issue which the Commission had not explored, or to update the Commission's assessment in light of latest market evidence.
- 3.4 In respect of the Commission's projection of the Q5 opening Regulatory Asset Base, the CAA examined the following aspects in particular:
- Stansted Generation 1 (SG1) capital expenditure on minor projects in 2008/09; and
 - Stansted Generation 2 (SG2) preliminary expenditure during the Q4 price control period.

In respect of these specifics and the Q5 opening RAB in general, the CAA found the Commission's recommendations to be reasonable having regard to the CAA's statutory objectives.

- 3.5 In respect of traffic forecasts, the CAA considered the Commission's own traffic forecasting methodology, its input assumptions, and its central and other traffic scenarios. The CAA then set out and assessed updated information (available since the Commission reported) on traffic and airline intentions, economic conditions and oil prices.
- 3.6 The CAA considered that the Commission's Q5 traffic forecast was a reasonable assessment at the time it was made, given the information then available. The emerging evidence since then, related primarily to the macro economy but also with some direct consequences for demand for air travel at Stansted in the early years, at least, of Q5, pointed to there being somewhat more risk on the downside of the Commission's forecasts. The CAA then set out a range of traffic scenarios, each lower than the Commission's own central projection, and illustrated the potential upward impact of such reduced traffic (as an isolated factor) on a 'building block' price cap calculation.
- 3.7 In respect of the Commission's projection of capital expenditure in Q5, the CAA examined in particular the SG1 25+ planning project. The CAA considered that it was reasonable for the Commission to include BAA's own estimates of the level and profile of costs for the 25+ planning project within its projections of Q5 capex at Stansted. More broadly, the CAA concluded that the Commission's assessment of the evidence and views presented appeared to have been a reasoned judgement, taking all relevant factors into account, and seeking to reach a set of recommendations which reflected the Commission's own interpretation of the CAA's statutory objectives. The CAA noted that the Commission's conclusions with respect to capital expenditure, cost efficiency and construction price inflation were reached in the specific context of Stansted Airport and within the current particularly uncertain economic climate. The CAA therefore accepted that the Commission's proposed capex projections, predominantly the SG1 agreed baseline programme, represented a reasonable input for the purposes of computing a RAB-based price cap.
- 3.8 In respect of the Commission's projection of operating expenditure in Q5, the CAA reviewed in particular the updated waste cost forecasts, and concluded that no update to this aspect of the Commission's projections would be warranted. More broadly, having reviewed the Commission's analysis, the CAA took the view that the Commission had conducted a proper assessment of the efficient level of operating costs which Stansted would incur during Q5 to meet the projected demand for capacity and service quality embodied in the rest of the Commission's analysis. The CAA therefore considered that the Commission's operating expenditure projections were a reasonable and appropriate basis for constructing a RAB-based price cap.
- 3.9 In respect of other income (commercial and non-regulated revenues which are considered alongside airport charges within the single till), the CAA

considered the Commission's assessment. It concluded that the Commission had conducted a proper assessment of the non-regulated commercial and aeronautical revenues which Stansted could be expected to generate during Q5, given the projected demand for capacity and service quality embodied in the rest of the Commission's analysis. The CAA therefore considered that the Commission's projections of other revenues would represent a reasonable and appropriate basis for constructing a RAB-based price cap. The CAA noted, however, that the deteriorating economic conditions since the Commission reported might have made these projections more challenging.

- 3.10 With regard to the recommended transparency from BAA to airline users on the levels of, and changes to, non-regulated aeronautical charges, the CAA agreed with the Commission. The CAA set out its proposed extension to the existing public interest condition on Stansted which requires disclosure of information to users on a range of 'specified activities'. The CAA welcomed the commitment from BAA that, as throughout the Q4 period, BAA Stansted would continue to consult annually throughout Q5 on changes to charges, this consultation to include providing an annual update to users of estimates for the costs associated with non-regulated charges.
- 3.11 In respect of the cost of capital, the CAA considered the analysis undertaken by the Commission and concluded that the Commission had conducted a proper assessment of the appropriate cost of capital to use for the Q5 period in setting a RAB-based price cap for Stansted. The CAA therefore considered that the Commission's cost of capital estimate would be a reasonable and appropriate basis for constructing a RAB-based price cap.
- 3.12 The CAA went on to lay out updated evidence from the debt markets, notably on the redemption yields of certain investment grade bonds and of index-linked gilts. It concluded that the latest evidence on each of these factors would not warrant adjusting the Commission's overall estimate of the Q5 cost of capital for the purposes of setting a 'building block' price cap.
- 3.13 In respect of financeability, the CAA reviewed the Commission's assessment and concluded that it had conducted a proper assessment of the financeability of its recommendations for setting a RAB-based price cap for Stansted during the Q5 period. The CAA noted that the Commission had adopted, and in some cases adapted, several of the approaches to analysing financeability which the CAA itself utilised in the Heathrow and Gatwick price control review. It also noted that the financial ratio analysis conducted by the Commission was based on the underlying premise that the airport operator would, in each year of Q5, be able to price up to the projected cap and recover the total airport revenues implied by the price and traffic forecast in combination. Against this background, the CAA considered that the Commission's financeability analysis was a reasonable basis for judging whether Stansted's business was likely to be robustly financeable under the RAB-based price cap recommended by the Commission. The CAA had not

seen any evidence which would cause it to seek to revisit the Commission's analysis on this point.

- 3.14 The CAA, having reviewed the overall resulting maximum level of airport charges recommended by the Commission, went on to consider the implications of the annual inflation projections used by the Commission (for the years 2008/09 and 2009/10) in light of the latest available evidence on inflation trends. The CAA noted that inflation outturn data for 2008/09 had been falling over autumn 2008 and that forecasts for 2009/10 had also fallen over the same period. It indicated the potential impact of a downward adjustment of inflation projections from the levels adopted by the Commission on the nominal price cap implied by the Commission's recommendations.
- 3.15 The CAA's overall assessment (taking the Commission's analysis and recommendations and subsequent market evidence into account) was that:
- the Commission had conducted a proper assessment of all of the components required for setting a RAB-based price cap for Stansted during the Q5 period;
 - despite the relatively short period of time since the Commission reached its conclusions, the economic situation had significantly deteriorated. The implications of this deterioration affected the 'building block' calculations in different directions. Overall, the CAA considered that there was no clear-cut case for adjusting the Commission's price profile to reflect new information on the individual cost, revenue and traffic building blocks; and
 - the CAA therefore concluded that the Commission's recommended price caps represented reasonable estimates of the maximum limits on airport charges at Stansted on the basis of RAB-based cost 'building block' approach.
- 3.16 The CAA then went on to adjust the Commission's recommended limits on airport charges to reflect the fact that the CAA proposed to implement (as recommended by the Commission) separate price caps on passenger and non-passenger flights. This involved the CAA subtracting a projection of airport charge revenues from non-passenger flights from the Commission's total airport charge revenue projection over Q5, and then calculating an airport charge cap for passenger flights.
- 3.17 Finally, the CAA set out three options for the profiling of the resulting airport charge revenues over the Q5 period which delivered three options for the profile of price caps on airport charges on passenger flights.

Consultation responses

3.18 Responses on these aspects of the CAA's December 2008 proposals were received from the SACC, Ryanair and BAA. In general, respondents argued that the CAA should undertake more thorough and, in some cases, more transparent analysis of a number of the 'building blocks' which the Commission assessed and incorporated in its recommendations to the CAA. Airline respondents and BAA each challenged different aspects of the Commission's analysis and recommendations and the CAA's own assessment of these recommendations in light of latest market evidence.

SACC

3.19 The SACC welcomed the CAA's acknowledgment that the price control review was concluding in adverse economic conditions, which could reduce traffic demand at Stansted. The SACC criticised, though, the CAA's 'broad brush' approach to the issue, and argued for greater CAA scrutiny of individual 'building blocks'. It considered that, given the sharpness of the economic downturn over autumn/winter 2008/09, it was not sufficient for the CAA simply to accept the judgements made by the Commission without first testing their robustness to current circumstances. Such a reappraisal should take into account all affected factors, not simply traffic forecasts.

3.20 The SACC considered that the CAA had not given adequate consideration to those factors where the Commission had not itself reached a definitive view (traffic, inflation, some elements of capital expenditure, and the cost of capital), and that the CAA had not set out its consideration of the issues transparently.

3.21 With regard to the Commission's conclusion on the level of the opening RAB and the CAA's assessment of this, the SACC expressed a number of concerns:

- it considered it 'perverse' that the Commission had allowed all of the Q4 capital expenditure into the opening RAB, despite the Commission finding that consultation on investment during Q4 (one of the tests set out by the CAA at the start of the quinquennium for assessing the RAB in future) had been so deficient as to be against the public interest;
- the SACC's concerns in this respect applied particularly to the terminal arrivals extension, which the SACC considered had been subject to inadequate consultation and was now not meeting the commercial revenues projections on which its business case had been predicated;
- overall, the SACC argued that some £70 million be removed from the opening RAB on account of capital expenditure that was subject to inadequate consultation, was opposed by users, and/or has been inefficiently incurred;

- the SACC considered that the CAA's assessment of the 2008/09 minor projects (as recommended by the Commission) lacked transparency and that, as there had been no consultation by the airport operator with users, the CAA should remove from the RAB the excess of capital expenditure above the £20 million limit previously agreed between STAL and the SACC; and
- the SACC reiterated its long articulated views that BAA's consultation with users on both SG2 preliminary expenditure and on the SG2 plans themselves had been inadequate. As such, and in light of the Commission's adverse public interest finding against STAL's consultation performance during Q4, the SACC considered that there was no case for including any SG2 preliminary expenditure in the Q5 opening RAB.

3.22 In addition, the SACC argued that BAA had over-recovered the amount of unpublished discounts (allowed as marketing support in operating expenditure projections) in the last year of the extended Q4, and that therefore there should be a downward adjustment to the starting price cap for Q5 to reflect this. Given that one potential mechanism for effecting such a change might be a downward adjustment to the Q5 opening RAB, the CAA considers the SACC's views on this topic in its discussion of opening RAB issues.

3.23 With regard to the Commission's conclusions on projected operating costs, the SACC was broadly content with the assessment of the scope for efficiency gains. It remained concerned however with the lack of transparency on the level of central overhead costs apportioned to capital projects at Stansted. It also raised concerns about additional costs and risks which it considered users were now having to bear for airport air navigation services, following the ending of direct charging by NATS of airlines, replaced by BAA contracting with NATS and recovering its costs through airport charges.

3.24 With regard to other revenues, the SACC was concerned that the Commission may have erred in excluding from its commercial revenue projections the revenue associated with projects now excluded from the Q5 capital expenditure projections, as such revenue was likely to be recouped elsewhere across the airport. On non-regulated aeronautical charges, the SACC expressed concern about the scope for airlines to be 'double charged' during the quinquennium, and requested greater transparency from the CAA on the assumed allocation of costs and revenues to the regulated airport charges and non-regulated revenues respectively.

3.25 With regard to the cost of capital, the SACC considered that Stansted should have a cost of capital the same as that of Gatwick.

- 3.26 With regard to price profiling, the SACC (while rejecting the dual rationale advanced by the CAA for its proposed profile and reiterating its arguments for a lower recalculation of a number of cost ‘building blocks’) agreed in principle that a lower cap at the start of Q5, rising gently, would be preferable to a more varying price path.

Ryanair

- 3.27 Ryanair indicated that it had contributed to, and fully endorsed, the detailed submission of the SACC. In addition, Ryanair made a number of observations on the assessment of the Commission’s ‘building block’ analysis:
- it objected to the inclusion of any SG2 preliminary expenditure in the opening RAB, on the grounds that BAA had not consulted users on this spending, that it thus failed to meet the requirements set out by the CAA for allowing such expenditure, and that users remained opposed to the SG2 plans; and
 - it considered that the CAA should now properly address those issues on Stansted’s costs (identified by the SACC in its submission) that had been left unresolved by the Commission;
 - it indicated that traffic at Stansted was likely to fall further from current levels in the next couple of years, given the economic background and the airport’s current and prospective approach to charging.

- 3.28 Ryanair also provided further evidence, subsequent to the oral hearings on 9 February, in support of its argument that airlines were now unfairly bearing higher airport ANS charges as result of the new contractual arrangement in place between BAA and NATS since April 2008. In addition, it was concerned that airlines would not benefit from rebates from NATS to BAA for any service failures in the ANS provision.

BAA

- 3.29 As noted in chapter 1, BAA made the overall observation that it considered that the CAA had not argued convincingly why its proposals were not reflective of a standard RAB-based approach. As such, BAA considered that the CAA should ‘come to a view’ on the building blocks.
- 3.30 BAA raised a number of concerns on several of the ‘building blocks’ and the CAA’s assessment of the Commission’s analysis and conclusions.
- 3.31 With regard to the opening RAB, BAA raised the following issues:
- there should not be any clawback of the RAB in respect of the BAA Q3 pensions holiday, which would be an unjustified reopening of previous regulatory decisions; and

- there was no case for the exclusion of £37 million of SG2 preliminary expenditure from the opening RAB, and that the Commission's recommendation in this respect was unfounded on fact or good evidence, and should therefore be challenged by the CAA.
- 3.32 With regard to traffic, BAA noted a general softening of demand at Stansted. In the context of the SG2 planning inquiry, BAA submitted in mid February a revised forecast indicating lower traffic than previously forecast by 2015, and a later assumed opening date for a second runway.
- 3.33 With regard to Q5 capital expenditure projections, BAA agreed with the Commission's approach not to include, at this stage, any expenditure on the construction costs of the planned second runway and associated facilities. It agreed with the proposed allowance of £40 million to enable BAA to take the project through the planning approval process, and sought some assurance from the CAA as to the future regulatory treatment of such expenditure if incurred in a timely and efficient manner. It disagreed with the Commission's disallowance of some 6 per cent of the capital expenditure on agreed SG1 projects (on grounds of efficiency improvements assessed by the Commission's consultants Currie & Brown).
- 3.34 With regard to operating expenditure projections, BAA offered no further comments beyond noting that it did not agree with the CAA's conclusions.
- 3.35 With regard to other income, BAA argued that the additional retail and car park yields which the Commission had predicated as part of its overall commercial revenue projections had been unrealistic and were more so now in light of deteriorating economic conditions. BAA considered that the CAA should review these projections again in light of all the evidence now available.
- 3.36 With regard to the cost of capital, BAA considered that there were grounds to argue that the cost of capital for Stansted Airport had increased since the Commission's analysis in September 2008:
- the cost of equity capital and hence the equity risk premium had increased over this period due to increased volatility and uncertainty. Overall, BAA and its consultants Oxera suggested an ERP of at least 5.0 per cent would be an appropriate estimate for Q5;
 - observed volatility of measures of the risk free rate alongside uncertainty about future Government debt funding and other capital market developments suggested that a prudent estimate of the RFR would be in the range 2 to 2.5 per cent; and
 - updating the Commission's estimates of the cost of newly issued debt for latest market evidence and a revised RFR would result in a range of 4.85 to 5.15 per cent (pre-tax real). Reflecting the actual costs of

embedded debt and the actual costs incurred by BAA for debt issuance costs and fees, BAA argued that the all-in real pre-tax cost of debt for Stansted in Q5 would be 4.8 per cent.

- 3.37 With regard to financeability, BAA argued that the marginal nature of Stansted with respect to demand in the London region meant that it was more exposed to volume risk than other airports in London, and as such was likely to have seen an increase in relative risk, hence beta, since the beginning of the market turmoil. Facing greater business risk, a stand-alone Stansted would now be less likely to achieve its target credit rating of A- under the Commission's notional gearing assumption of 50 per cent. To the extent that the financeability test would be failed, BAA argued that the proposed cost of capital was too low.

CAA assessment

- 3.38 The CAA sets out in the following section its assessment of the Commission's recommended 'building blocks' and the price cap which results from this analytical approach, in light of the views and evidence received in consultation and the latest available evidence on relevant macro-economic and financial markets developments. As noted above, the intention of this assessment is not to arrive at single point estimates for individual 'building blocks'. The CAA's purpose in reviewing the individual 'building blocks' is rather to reassess whether the individual 'building blocks' and the resulting price caps continue to fall within the range of caps that could reasonably be recommended by a regulatory authority applying a 'building block' methodology against the objectives set out under section 39 of the Airports Act. This assessment considers first, capital expenditure and Regulatory Asset Base issues; second, other 'building blocks'; and third, the overall potential impact on the 'building block' analysis recommended to the CAA by the Commission.

(i) Assessment of capital expenditure and Regulatory Asset Base issues

- 3.39 BAA and the airlines raised a number of different challenges to the Commission's cost 'building block' judgements on the RAB and capital expenditure and the CAA's assessments thereof. These are discussed in turn below.

Q5 opening RAB

- 3.40 The CAA in its 2003 price control decision for Heathrow, Gatwick and Stansted airports stated its regulatory policy on the evolution of the Regulatory Asset Bases at each airport as follows:

'However, providing BAA follows best practice management and operates pro-actively the enhanced information disclosure and consultation

agreement, consulting effectively with well-informed users, the CAA sees no good reason for disallowing capital expenditure at the next review.’¹⁰

3.41 With regard to SG2 preliminary expenditure, the CAA set out the following criteria in its March 2006 statement on this topic:

‘The CAA currently takes the view that there is a case for allowing net preliminary expenditure, including an annual return of 7.75% to be added to the Stansted RAB at 1 April 2008, having regard to the extent to which:

- (a) as far as practicable, BAA consulted users (including both airlines and passengers) on the level of preliminary expenditure before it was incurred;
- (b) BAA had followed best practice management and operated pro-actively the enhanced information disclosure and consultation agreement, consulting effectively with well informed users;
- (c) the expenditure was genuinely additional and related to the development of new runway capacity with any additional return being included in the Stansted RAB based on the excess of total outturn capex over and above the projections made at the time of the last price control review, up to a maximum return equal to the return on net preliminary expenditure’.

3.42 The CAA considers that these statements have a number of implications, discussed below, which are relevant to the concerns raised in consultation on the subject of the Q5 opening RAB.

3.43 The CAA’s specific 2003 statement quoted above was made in the wider context of its policy towards ‘clawback’ of capital investment, where the CAA said¹¹: ‘The CAA cannot give definitive guidance on this matter [future treatment of clawback]. However, the CAA’s general policy is that claw-backs are highly undesirable and undermine the incentive properties of price cap regulation. The claw-backs in Q3 should be viewed as a ‘one-off’ in the extreme circumstance where the key element of the capital expenditure plan was delayed due to an unexpected delay in obtaining planning permission for Terminal 5’. It is apparent that the CAA’s intention was to give adequate guidance to BAA to encourage investment in time to meet demand, while at the same time protecting users’ reasonable interests in terms of consultation and project efficiency. It is also apparent from the context (e.g. the use of the word ‘extreme’) that the CAA did not intend to use the twin criteria to put in place a regime which would have as its effect the ‘clawback’ or ‘disallowing’ of capital expenditure which had been developed and implemented within the range of normal behaviour by the airports.

¹⁰ Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003 - 2008 CAA Decision February 2003, paragraph 6.10

¹¹ *ibid*

- 3.44 The regulatory policy is expressly framed in positive terms ('project efficiency and consultation imply capex allowed in RAB'). This statement is logically equivalent to 'capex disallowed from RAB implies either inadequate consultation or project inefficiency or both' – using these terms as shorthand). This statement is not equivalent to the construction which the airlines have adopted in their recent submissions (which might be summarised as 'project inefficiency or inadequate consultation imply capex disallowed from RAB').
- 3.45 The Commission in its report to the CAA does not fully or accurately reflect this logical and policy distinction. It reports the 2003 criteria as follows: 'In its 2003 determination, the CAA set out two overall **criteria for including capex** in Q4: (a) adequate consultation with airport users, as specified by the enhanced information disclosure and consultation requirements set out in Annex 4 to its 2003 determination; and (b) efficient management of the investment projects undertaken during Q4'¹² and '**there must be** (a) [consultation] and (b) [project efficiency, both as described above]'¹³ (emphasis added). The CAA's 2003 criteria could better be described as criteria for not excluding capex. The result of this approach is that its judgement is likely to have been against a higher standard than the CAA originally intended: the Commission may have tended to look for projects that passed both criteria and to disallow those that did not meet either or both criteria.
- 3.46 The Commission does report correctly the criteria that the CAA published in March 2006. The CAA's March 2006 statement on SG2 is clearly expressed in positive terms (cf 'there is a case for allowing'), it includes the concept of proportionality (cf 'the extent to which'), and it introduces a further dimension of regulatory judgement ('having regard to' versus 'sees no good reason' in the CAA's 2003 criteria).
- 3.47 The Commission stated that it had adopted the CAA's criteria (2003 and 2006 for SG1 and SG2 projects respectively), as the appropriate criteria for considering the inclusion of capex in the RAB, and had formulated its recommendations accordingly¹⁴.
- 3.48 To put these regulatory policy statements into practice clearly requires a considerable degree of regulatory judgement. The two key terms of the 2003 statement are 'best practice management' and 'operates pro-actively the enhanced information disclosure and consultation agreement, consulting effectively with well-informed users'. Both require a judgement about the airport's performance, and about the airlines' engagement with the airport, in the context of the nature of the specific projects. The policy statement includes several qualifiers ('best practice', 'pro-actively', 'effectively', 'well-

¹² CC October 2008, paragraph 6.7

¹³ Ibid, Appendix D, paragraph 15

¹⁴ Ibid, paragraph 6.8

informed'), none of which can be judged unequivocally and each of which implies a standard against which the airport's performance is judged. In addition, the 2006 statement includes the qualifier 'as far as practicable' and the explicit role of judgment ('having regard to').

- 3.49 As the CAA has discussed at length with the Commission during the course of its Stansted and BAA market inquiries, the CAA considers that the view of both the CAA and the Commission in 2003 was that the focus of the consultation assessment would be each airport's annual Capital Investment Plan (CIP): 'BAA has undertaken to produce a revised capital investment plan consistent with the agreement in April 2003. This will provide the basis for more effective consultation and strategic dialogue with users. The CAA considers that effective consultation by BAA will make it more worthwhile for interested users to engage in the process'¹⁵.
- 3.50 The Commission in its Stansted inquiry criticised the quality of consultation based on the CIP: e.g. 'The information which was to form the basis of consultation was taken by both BAA and the CAA to mean the provision of the annual CIP by BAA to the airlines and discussion based on this document. The airlines strongly disagreed and believed that further information was required, including the provision of a much more comprehensive airport business plan. We found that the CIP was insufficient to inform the airlines and to enable effective consultation. Indeed, we found that it was insufficient for us or our consultants to perform an ex-ante review of BAA's capex programme'¹⁶.
- 3.51 Notwithstanding this, the Commission adopted the criterion of whether a project was described in the CIP as its test of consultation for non-SG2 projects, as its interpretation of the CAA's own interpretation of the criterion. The CAA, in practice, adopted a broader criterion than the Commission in its own assessments of Heathrow and Gatwick airports, drawing on the CAA's scrutiny study of the qualitative nature and impact of consultation¹⁷, as well as the content of CIPs during Q4. In some cases, this has led the CAA to include projects in the opening RAB which were not formally part of the annual CIP (e.g. on grounds of need for timely in-year investment, or proportionality given scale of project). In other cases, the CAA concluded against one project at Heathrow which had undergone some consultation, the results of which did not appear to have been taken on by BAA¹⁸.
- 3.52 The Commission adopted different criteria in finding that the airport had operated against the public interest in respect of its consultation with airline

¹⁵ Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003 - 2008 CAA Decision February 2003, paragraph 3.63

¹⁶ CC October 2008, Appendix M, paragraph 21

¹⁷ Cotterill report, December 2006

¹⁸ Economic regulation of Heathrow and Gatwick airports 2008-2013, CAA decision, March 2008, paragraph 9.43-9.47

users during Q4. The Commission's implied criteria for the public interest finding were¹⁹:

- effective consultation must encourage two-way dialogue between the airport and the users of the airport; and
- exchange of information should be sufficient for all parties to take part in a well-informed discussion on the issues that are important to each side, covering both historical and proposed future projects.

3.53 Against these tests, the Commission found that: 'information provided by BAA to the SACC was frequently too insufficient and untimely to enable effective consultation. ... overall, we found that the consultation process, with regards to the development of the airport and BAA's capex programme, failed and this failure had adverse effects both on the charges levied (in the following quinquennium) and on the operational activities of the airport and its users. We found that BAA's conduct with regard to consultation at Stansted in Q4 had operated against the public interest'²⁰.

3.54 The SACC in its supplementary written submission to the CAA of 11 February considered that the Commission had erred in recommending certain Q4 capex be allowed in the Q5 opening RAB and that this error stemmed from the Commission's differential tests applied to BAA's consultation performance. The SACC argued that:

- the Commission found that BAA's consultation on capex had adversely affected users' reasonable interests (both with respect to airport operational activities, hence charges and airport efficiency and effectiveness, and with respect to capex efficiency);
- if capex were allowed into the RAB for which there had been inadequate consultation, then the Commission's public interest finding implied that such inclusion would adversely affect users' reasonable interests; and
- therefore, if the CAA were to follow the Commission's reasoning and recommendations, the CAA would be in breach of its first statutory duty to further the reasonable interests of users.

3.55 The CAA draws the following conclusions from the issues discussed above, considered in the context of its December 2008 price control proposals for Stansted.

3.56 First, the Commission's interpretation of the CAA's 2003 regulatory policy statement with respect to the Q5 opening RAB could have resulted in the Commission focusing, in principle, on a narrower sub-group of projects than

¹⁹ Ibid, paragraph 13.10

²⁰ Ibid, paragraph 13.14

implied by a reasonable regulatory and logical interpretation of these criteria. In practice, though, the Commission concluded that all SG1 Q4 capital expenditure fell within this potentially narrower sub-group (albeit it recommended further scrutiny of 2008/09 minor projects which were not capable of being assessed by reference to its CIP criterion).

- 3.57 Second, the consultation criterion, in its own right, applied by the Commission for SG1 projects was less flexible and in some cases a lower threshold than that used by the CAA in setting a RAB-based price cap at Heathrow and Gatwick (where the CAA was also informed by an independent assessment of BAA's consultation performance during Q4). Nevertheless, it was a reasonable interpretation for the Commission to adopt, and was consistent with the regulatory statements made by the CAA in its 2003 price control decision, and was thereby conducive to meeting reasonable expectations of BAA and the airlines. As noted above, one consequence of applying this criterion rigidly as the Commission did is that 2008/09 minor projects fall outside of this criterion by definition and have to be subject to separate regulatory judgement.
- 3.58 Third, the Commission adopted the CAA's latest published statement of its then current views (in early 2006) on criteria for allowing SG2 preliminary expenditure into the opening Q5 RAB. This was a reasonable position for the Commission to adopt, was clearly consistent with the regulatory statements made by the CAA, and was thereby conducive to meeting reasonable expectations of BAA and the airlines.
- 3.59 Fourth, the Commission applied a materially higher test in its assessment of BAA's consultation performance for the purposes of its public interest finding than that applied to its assessment of SG1 capital expenditure. The Commission's test on SG2 preliminary expenditure consultation appears, in practice, to have been closer to its public interest test, as reflected in the explicit criticisms of BAA's consultation on each of the elements of SG2 preliminary spend: the Commission found that BAA failed to consult users 'effectively ... in advance of the expenditure' (fees)²¹ or to consult at all in advance of expenditure (BAA project costs)²². The Commission cited these among the factors taken into account in deciding not to allow a proportion of each of these cost items into the RAB. In the case of blight, the Commission also criticised BAA's consultation (but less severely – 'without adequate consultation with the airlines'²³), but concluded in light of all factors that blight costs should be allowed in full in the RAB. So the Commission appears to have drawn on relevant evidence on consultation in reaching its views on SG2 preliminary expenditure, and to have reached conclusions differentiated by the type of expenditure.

²¹ *ibid*, Appendix D paragraph 175(a)

²² *ibid*, Appendix D paragraph 185(a)

²³ *ibid*, Appendix D paragraph 147

- 3.60 Fifth, the Commission's differentiation of its criteria between its opening RAB and public interest findings is clearly articulated and a reasonable distinction for a regulator to make, bearing in mind the differential impact of an adverse judgment on the RAB versus an adverse public interest finding²⁴. The former would lead (in a RAB-based price cap) to a lower price cap and (to the extent that the airport is constrained in pricing by the cap) to the airport operator losing the ability to recover the principal and return on the disallowed investment. This could have a material impact on the incentives to timely investment at Stansted and potentially at other airports, to the extent that the Commission's and the CAA's judgements for Stansted affect perceptions of the regulatory treatment of Heathrow and Gatwick. The latter would lead (under the Commission's recommended approach) to a behavioural condition being placed on the airport operator, aimed at improving future consultation, but with no financial penalty for failures in the past. This conclusion and remedy clearly has a much lower potential to affect investment incentives adversely (albeit it sets higher behavioural standards against which any future assessment of consultation for the purposes of determining a RAB could be based).
- 3.61 Sixth, the CAA in reaching its price control decision must act in the manner which it considers best calculated to meet all four of its statutory objectives, and not simply focus on furthering users' reasonable interests. Therefore, it was reasonable of the Commission to consider all four of the CAA's statutory objectives when making recommendations on the Q5 opening RAB and other aspects of the price control. The Commission explicitly stated that it had had regard to the CAA's statutory objectives: 'given that our recommendation directs the CAA in the performance of its functions, we have previously had regard to the CAA's duty to act in the manner which it considers best calculated to achieve its objectives, and have done so again in this review'²⁵.
- 3.62 In the CAA's view, having regard to all four statutory objectives and to the differential impacts of behavioural remedies on future behaviour versus the immediate and enduring impact on investment incentives of any disallowance of Q4 capex from the Q5 opening RAB, the Commission's recommendations on the opening RAB fall within the range that could reasonably be recommended by a regulatory authority applying a 'building block' methodology against the objectives set out under section 39 of the Airports Act. It is therefore reasonable for the CAA to place reliance on this analysis and recommendation, which is not incompatible with the CAA's objectives in respect of users and others under the Airports Act nor is it internally inconsistent, as the SACC has argued.
- 3.63 In the CAA's view, the Commission's recommended exclusion of some SG2 preliminary expenditure from the Q5 opening RAB, that the exclusions were differentiated by type of spending, and that the differentiation reflected the

²⁴ *ibid*, Appendix D paragraphs 16-18

²⁵ *ibid*, paragraph 2.7

Commission's assessment of BAA's differential performance on consultation and efficiency of spend, were also reasonable applications of the criteria for SG2 preliminary expenditure that the CAA published in March 2006. The Commission clearly had regard to the 2006 criteria and had applied a proportionate judgment on each item of spend, reflecting both the consultation and project efficiency criteria.

3.64 In summary, the CAA considers that:

- the Commission's criteria for assessing the Q5 opening RAB were reasonable;
- the Commission's application of these criteria was reasonable, and made in light of all available relevant evidence; and
- the Commission's analysis and recommendations with respect to the opening RAB were consistent, legally and logically, with its findings and recommendations on public interest matters.

In light of the above, the CAA continues to believe that the Commission's overall assessment and recommendations with regard to the opening RAB are reasonable. The specific items within the opening RAB assessment which have been challenged in consultation responses are considered below.

SG1 capital expenditure during Q4

3.65 The SACC challenged a number of these projects on grounds of inadequate consultation. This challenge has been addressed by the CAA in the preceding analysis. The SACC also argued that one project (Arrivals extension, involving capital expenditure of £49 million) should be excluded from the RAB on the following grounds: 'To the extent that BAA sought to justify this project to users, it did so on the basis that it would generate substantial incremental commercial revenues in total and on a per passenger basis ... In the light of BAA's projections for decline in retail revenues per passenger during Q5, the SACC considers that BAA misled users in proceeding with this project and that the CAA is duty bound to exclude the expenditure unless it is clearly able to verify that the project is net beneficial to the single till and that the commercial revenue per passenger is net incremental'.

3.66 In the CAA's view, the additional argument adduced by the SACC is equivalent to saying that all projects should be subject to a post implementation review, to test whether *ex post* the project has met the cost benefit projections on which it was originally predicated and, if not, should be excluded from the RAB. This 'perfect hindsight' test of investment efficiency is not part of the CAA's (nor the Commission's) regulatory approach to scrutinising capital expenditure at any other airport. To apply such a novel test now would introduce a significantly higher level of regulatory risk for the

airport operator, and could cause a significant adverse impact on investment incentives, which (in the CAA's view) would not be in users' medium term interests. At present, this risk is not reflected in the cost of capital recommendation by the Commission. The CAA concludes therefore that, notwithstanding the SACC's challenge, the Commission's recommendations as to inclusion of this project in the opening RAB remain reasonable, as do its conclusions on the other major SG1 projects which the SACC has challenged.

2008/09 minor projects

- 3.67 The Commission recommended that all capital expenditure in this category be included in the opening RAB, but also recommended that the CAA review these projects again in greater detail. The Commission noted that 'we have no evidence on them'²⁶.
- 3.68 The CAA did review these projects in greater detail. The review (which was summarised in the CAA's December 2008 proposals²⁷) entailed the following steps:
- sorting of projects by size to focus analysis on those projects accounting for the bulk of the spend (the largest 24 projects accounting for 60 per cent of the total spend were considered, beyond which point the long tail of very much smaller projects started);
 - scrutinising the cost advisory sheets and statement of need for each of the largest 24 of the full list of 134 projects, accounting for 60 per cent of the total spend of £63 million.
- 3.69 The results of this analysis (also summarised in the December proposals) were as follows:
- 'on costs' looked to be high, largely as a result of a too uniform approach to applying standard 25 per cent contingency allowances;
 - construction rates where specified appear not unreasonable; some were high, but only by 10-20 per cent;
 - given the projects were to be delivered within one year, the level of detailed project breakdowns on some of them appeared below what might be expected. Where such breakdowns were provided they appeared reasonable, but this detail was not provided for most projects. The closer to delivery, the more detail would be reasonably expected;
 - based upon the project descriptions, most projects appeared to be

²⁶ *ibid*, Appendix D, paragraph 86

²⁷ CAA December 2008, paragraph 3.11-3.13

required, but there were question marks about the ability of the airport to deliver them all in 2008/09; and

- the analysis and indeed management of this portfolio of projects was hindered by the absence of an organised programme within which smaller projects could be brigaded together.

In conclusion, while the projects appeared necessary, there were doubts as to whether all would be delivered within 2008/09, given the weaknesses identified in programme management, and the costs appeared to be 10-20 per cent higher than might be achievable with tighter management.

3.70 The SACC challenged the CAA's conclusions as being based only on a sample of projects; not being transparent in its assessment; and retaining the Commission's opening RAB recommendation despite finding shortcomings within these projects.

3.71 The CAA makes the following observations on the above:

- it is reasonable for the CAA to conduct a proportionate level of analysis, relative to scale of the issue in question. Given the context of the CAA's overall approach to the Q5 price caps, and the scale of capital expenditure in question, the sample analysis of larger projects was, in the CAA's view, appropriate. The CAA is not aware of any reason to believe that the sample that it used was not representative of all of the projects under consideration;
- the CAA did set out its assessment transparently, including a greater level of detail than the Commission typically provided for a comparable level of capital expenditure. The level of disclosure was adequate for interested parties to raise legitimate questions about the CAA's analysis and conclusions;
- the CAA was also transparent about the shortcomings it found in BAA's management and costing of these projects;
- neither the CAA's statutory objectives, nor any recommendation from the Commission, required the CAA to exclude some or all of the contested capital expenditure by virtue of this negative finding. As discussed above, under its previously stated regulatory policy on the opening RAB (as published in February 2003), the CAA had considerable scope to form its own proportionate judgement on the treatment of capital expenditure which did not fully meet either the consultation or project efficiency criteria. The CAA articulated the various factors weighed up in this judgement in the December proposals²⁸, in the following terms:

²⁸ CAA December 2008, paragraph 3.13

‘3.13 In light of this, the CAA is of the view that there may have been a case for the Commission, in reaching its judgment on the opening Q5 RAB, to have adjusted downwards the estimate of Q4 capex to be included in this RAB, to take account of projections of 2008/09 capex on minor projects somewhat in excess of the likely efficient level of investment needed in this year. Against that, the CAA also recognises that there is a genuine requirement for these projects, and hence if the Commission had scaled back Q4 capex in light of the factors above, there would have been a case to increase projected Q5 capex to allow for some of these projects to be deferred into Q5 – with very little net impact on Q5 price caps calculated by reference to cost building blocks. Taking the materiality of the projected level of capex into account, and looking forward also to the Commission’s assessment of other aspects of the opening Q5 RAB (discussed below), the CAA therefore considers that the Commission’s conclusion to include in the opening RAB all projected capex in 2008/09 on minor projects was reasonable’; and

- in reaching its view in its December 2008 proposals, the CAA had regard to the Commission’s recommendations and followed the approach suggested by the Commission.

3.72 The CAA concludes therefore, having carefully considered the SACC’s presentation, that the CAA’s analysis has provided support for the Commission’s recommendation as to the inclusion of these projects in the opening RAB and that their inclusion appears reasonable in the context of applying a ‘building block’ approach against the objectives set out in section 39 of the Airports Act.

SG2 preliminary expenditure

3.73 As discussed above in the context of the overall criteria for inclusion of capex in the opening RAB, the CAA considers that:

- the Commission’s criteria, analysis against these, and its resulting regulatory judgements on SG2 preliminary expenditure were sound;
- the opening RAB analysis was consistent with the Commission’s separate analysis against different criteria for the Commission’s public interest findings;
- the CAA is able to accept as reasonable the Commission’s inclusion of capital expenditure in the opening RAB where consultation on that capital expenditure has been part of an action by the airport operator against users’ reasonable interests, by virtue of the CAA’s (and the Commission’s) assessment of price caps against all four of the CAA’s statutory objectives, and taking account of the differential impacts of excluding capital expenditure from the RAB versus a future

behavioural remedy on consultation.

- 3.74 The CAA concludes therefore that the SACC's, Ryanair's and BAA's arguments do not undermine the Commission's recommendations as to inclusion of the recommended level of SG2 spend in the opening RAB.

Impact of airport charge caps in year 6 of Q4

- 3.75 The Commission considered, against the public interest test, Ryanair's claim that Stansted's charges in year six of Q4 were excessive and concluded that BAA had not operated against the public interest in this respect. The SACC also argued to the CAA that it should adjust the Q5 price cap, through an adjustment to the Q5 opening RAB, to take account of the alleged over-recovery of revenue in year six of Q4.
- 3.76 The CAA has reviewed the SACC's argument, and supporting calculations. The CAA considers that the analytical approach undertaken by the SACC is not an appropriate basis against which to measure historical performance, as it focuses on a number of variances between individual forecasts and outturn performance, rather than considering more general and comprehensive measures of profitability. In addition, the calculations presented adopt assumptions, such as on the treatment of preliminary spend, that are not consistent with either the Commission's recommendations or the CAA's views on these 'building blocks'. Furthermore, the SACC's suggestion that the RAB should be reduced to recover historical out-performance would amount to a retrospective abandonment of the incentive framework inherent in the Q4 settlement (and in any RPI-X style price cap) in favour of a 'rate of return' style of regulation. The CAA does not consider that such a change in approach is appropriate at this time and does not consider that there would be a case for making any modification to the assessment of the opening RAB or the allowable revenue implied by a RAB-based price cap calculation.

Q5 opening RAB – conclusion

- 3.77 In light of the above, the CAA continues to consider that the Commission's recommendations with respect to SG2 preliminary expenditure and all other elements, which together comprise the Commission's recommended Q5 opening RAB, appear to be reasonable.

Q5 capital expenditure

- 3.78 In its December proposals, the CAA accepted that the Commission's proposed capital expenditure projections, predominantly the SG1 agreed baseline programme, represented a reasonable input for the purposes of computing the Commission's recommended RAB-based price cap. In responses to consultation, the following elements of the projected Q5 capital expenditure have been contested by the SACC and Ryanair:

- SG1 25+ planning projects;
- capital project on-costs; and
- SG2 planning costs.

These are considered below.

SG1 25+ planning projects

- 3.79 The CAA's assessment of these projects (totalling some £5 million) was challenged by the SACC on the grounds that the CAA had not 'fairly or transparently consulted on BAA's costs'. Noting that the SACC objected to the terms of these so-called s106 agreements at the SG1 planning inquiry, it argued that the CAA was 'under a duty to set out its reasoning in relation to each of these costs and to consult separately thereon'.
- 3.80 The CAA makes the following observations on the evidence and argument presented on this issue.
- 3.81 First, even in the context of a RAB-based 'building block' price cap, the impact of a £5 million capital project over Q5 on an opening RAB of £1.2 billion would be very limited, and the level of scrutiny and disclosure which the CAA provided in its December proposals would have been more than adequate for the CAA to satisfy its statutory objectives and general obligations to fairness of process. This conclusion stands *a fortiori* in the context of the CAA's regulatory approach to the Stansted Q5 price control, in which the Commission's 'building block' analysis provides only one part for the overall price control assessment.
- 3.82 Second, the fact that the SACC objected to the terms of the s106 agreements before they were settled is not directly relevant now that they have become (through the planning SG1 planning process) obligations on the airport operator. From the analysis undertaken by the CAA and reported in the CAA's December proposals, it appears that BAA now has very limited scope to vary the timing and costs of these projects, which appear to be triggered largely by local authority requirements. BAA indicated (at the February 2009 oral hearing) that it sought where possible to persuade the local authorities to defer such expenditure; nevertheless it could not rely on the authorities to do so, and the airport operator remained ultimately dependent on their decisions as to the timing of the expenditure incurred by the airport.
- 3.83 Third, the CAA has been transparent about the scale of these projects and the analysis it undertook. In the CAA's view, the SACC's complaint is more about the depth of the CAA's scrutiny than its openness and consultation with users. The CAA considers that the approach to scrutiny of capital expenditure is clearly a matter for the CAA's regulatory judgement, having

regard to its statutory objectives and general obligations as to procedural fairness.

- 3.84 In light of the above, the CAA confirms its analysis and conclusions on these projects, as set out in its December 2008 proposals and that it considers that its conclusions are consistent with its statutory objectives. It remains of the view that it was reasonable for the Commission – in the context of proposing a ‘building block’ price control - to include BAA’s own estimates of the level and profile of costs for the 25+ planning project within its projections of Q5 capital expenditure at Stansted.

Capital project on-costs

- 3.85 In its response to the CAA’s consultation, the SACC challenged the Commission’s assessment of these costs (totalling some £5-10 million over Q5) on the grounds that ‘these costs are inappropriately established by reference to an apportionment of central overheads rather than by consideration of what STAL actually needs by way of central support to its operations. The SACC believes, for example, that the costs of the head office project design and management team is apportioned on the basis of the initial budget set for a project not on the basis of work actually done. In the event that a project is abandoned, it is possible that high levels of apportioned costs will already have been accrued. Furthermore, the SACC never received satisfactory explanation as to the capitalisation of internal staff costs and considers that there may be recovery of some costs twice, through capex and again through opex. The SACC, therefore, calls on the CAA to urgently and transparently review these costs and to disallow/remove all such inappropriate costs from the RAB’.
- 3.86 The CAA considers that the points now being raised by the SACC with regard to project on-costs were substantively dealt with by the Commission and its consultants Currie & Brown (C&B), and by the CAA’s prior study into cost allocation by BAA to the designated airports. That study concluded²⁹ that: ‘In summary, Corporate Office direct costs [which include airport capital planning costs] are charged to businesses directly in relation to the services provided. This approach would appear to be consistent with best practice’. The Commission considered all this evidence, as well as views about reduced risk allowances and counter arguments from BAA, in concluding that the Stansted Q5 capital expenditure budget should be reduced by a 6 per cent capital efficiency factor. It appears to the CAA that the SACC has not produced in its consultation response any evidence in relation to this point that was not previously considered by the Commission and its consultants.
- 3.87 In light of the above, the CAA confirms its December 2008 assessment of the Commission’s Q5 capital expenditure projections on this issue.

²⁹ Supporting Paper VII Review of BAA’s revenue and cost allocation process, LECG, December 2009, paragraph 7.4

SG2 planning costs

3.88 The SACC challenged the inclusion of any SG2 planning costs in the Commission's assessment of Q5 capital expenditure, on the following grounds:

- any assessment as to the merits of one SG2 option or another would be premature pending the outcome of the Planning Inquiry and the CAA should not prejudice this outcome by favouring BAA's scheme over any alternatives in considering the regulatory treatment of expenditure, including preliminary expenditure;
- against the backdrop that the SG2 proposal being promoted by BAA was not supported by users and may not be pursued by new owners of the airport, it was not reasonable for substantial levels of preliminary expenditure, nor future planning application costs, to be included in the RAB and charged to users. It was unreasonable for users to be required to pay twice for the costs of obtaining planning approval to a scheme for development of additional runway and terminal capacity at Stansted (leaving aside the costs which the airlines were incurring in objecting to BAA's specific proposals); and
- the potential impact of BAA's current SG2 proposals on airport competition argue for deferring any decisions relating to the treatment of SG2, including preliminary expenditure, until such time as any new owner of Stansted has had the opportunity to come forward with a competitive scheme.

3.89 The Commission assessed the SG2 Q5 planning costs and their regulatory treatment in the following terms³⁰:

- it noted that similar arguments applied to whether these costs should be allowed in the regulatory settlement for Q5 as to whether the costs incurred in Q4 on the same items should be allowed into the opening RAB for Q5;
- it recognised that, currently, the SACC was opposing BAA's SG2 planning application, on the basis that BAA should be pursuing a lower cost option, and for this reason, the SACC submitted that it should not be required to pay the planning costs of the opposing party, in addition to its own costs; and
- the Commission noted that its only decision at this stage on SG2 for Q5, which does affect the price caps, was with regard to BAA's proposed pre-spend in Q5, which it anticipated to be sufficient to take it through to a planning decision. The Commission considered these costs and concluded that they were reasonable. It accepted the

³⁰ CC October 2008, paragraph 8.93, 8.94 and 8.116

purpose of these costs and it did not believe that they were excessive for what BAA needed to achieve over the coming months. Therefore, it recommended that the Q5 capital expenditure forecasts should include £40 million (in 2007/08 prices) for SG2 pre-spend.

3.90 It is apparent from this that the Commission did address directly the challenges from the SACC, both in terms of the principle of whether such expenditure should be included in the Q5 capital expenditure projections for the purposes of setting a price cap, and the practical question of the level of the projected spend. The CAA considers that the Commission's analysis and recommendation were reasonable at the time that they were made and, in the absence of any other developments since the Commission reported in October 2008, could have been relied upon by the CAA.

3.91 In practice, though, the level of uncertainty has increased markedly in recent weeks around the future prospects for the airport operator taking forward the planning application for SG2 as currently envisaged. This is due to a number of factors, including:

- the Commission's provisional decision in December 2008 to require the divestment of Stansted airport;
- the Commission's discussion in its provisional decision document for the BAA market inquiry³¹ about potential obligations which might be placed on a new owner of the airport to proceed with a planning application for a second runway;
- the SACC's and Stop Stansted Expansion's appeals to the Secretary of State for Communities and Local Government for deferral of the start of the SG2 planning inquiry from its 16 April 2009 start date;
- the Government's decision in January 2009 to support a third runway at Heathrow (subject to binding environmental tests being satisfied), including the following statement on the timing thereof: 'The airport operator may therefore wish to consider the submission of a planning application at the earliest opportunity, with a view to a third runway becoming available sooner rather than later within the broad timeframe contemplated by the ATWP (2015 to 2020), provided that its use is consistent with the environmental constraints'³²;
- BAA's February 2009 submission to the SG2 Planning Inspector and interested parties on forecasting issues, in which it indicated that it intended to use 2017 as the opening year of the second runway rather than 2015. BAA indicated then that it was nevertheless proceeding with the planning inquiry, and anticipating a deferred start to the 51-

³¹ CC BAA Airports Market Investigation, Provisional decision on remedies, December 2008, paragraph 128

³² Adding Capacity at Heathrow: Decisions Following Consultation, DfT, January 2009, paragraph 71

month construction programme in 2013 rather than 2011;

- press reports³³ that BAA was likely to divest itself of Stansted in the coming year, without seeking a legal challenge against any divestment order which the Commission may make in its market inquiry; and
- most recently, the announcement of the Secretary of State for Communities and Local Government on 2 March 2009 that she had decided to delay her formal announcement of the SG2 planning inquiry timetable for a short time, in order to enable BAA to consider the findings and implications of the Competition Commission's final report on BAA Airports (due to be published no later than 28 March 2009).

3.92 The CAA notes the following factors which are also relevant to its assessment of this issue:

- the Commission was content that £40 million represented an efficient level of projected spend to include in the Q5 price control which it recommended;
- the Commission, in the BAA Market Inquiry, expressed support for the development of additional runway capacity in the South East of England in general and Stansted in particular, and has framed its proposed divestment remedy for Stansted accordingly³⁴: 'On balance, however, and recognising the difficulties in evaluating these uncertainties, many of which are contradictory, our current preference is to initiate the divestiture of Stansted as soon as possible, provided, following responses to this document that first, progress on the current planning application is unlikely to be unreasonably compromised and second, the overall objective of developing new runway capacity is not jeopardized'. From this one could reasonably conclude that, as at December 2008, the Commission would continue to support the inclusion of sufficient revenues within the Stansted price cap in Q5 to enable any owner of the airport to fund a planning application process, and would not necessarily support at this stage the exclusion of any funds for this purpose from a 'building block' price cap assessment; and
- the timing, duration and cost of any planning application are likely to remain uncertain well into the Q5 period. Information available to the CAA up to the point it makes its Q5 price control decision may, at best, only partially resolve some of the current uncertainties. There are likely to be further, currently unknown, uncertainties which emerge in the coming months and years which would affect the development of second runway plans during the Q5 period;

³³ Sunday Times, 22 February 2009

³⁴ BAA Airports Market Investigation, Provisional decision on remedies, CC, December 2008

- in considering the SACC's challenge on these capital expenditure costs, the CAA has considered not only users' reasonable interests in respect of airport charges and the basis on which they are set, but also the impact of any downward adjustment to the price control (as advocated by the SACC) on the CAA's statutory objective to encourage investment in time to satisfy anticipated demand by users. Notwithstanding the current economic recession and the adverse impact on current traffic levels at Stansted and on forecasts for the next few years, it is arguable (as the Commission does in its BAA Market Inquiry and Stansted reports) that there is case for enabling (and possibly encouraging) the airport operator to bring forward a planning application during Q5 for a second runway;
- were a planning inquiry to be deferred by some years, then spending on professional fees may be deferred but could be higher than originally projected (as a result of the need to refresh earlier analyses). Property blight costs could well remain as long as the Government's support for a second runway is in place, or until the airport operator set aside plans for expansion indefinitely; and
- the impact on a 'building block' price cap calculation of deferral/postponement of expenditure³⁵ could range from a reduction of ~0.4 per cent of the net present value of airport charge revenues in Q5 for a two year delay in non-blight costs, to a 1.1 per cent reduction for a three year delay in all SG2 preliminary expenditure, to a 1.5 per cent reduction if no such expenditure were projected for Q5.

3.93 In conclusion, in the CAA's view, the likelihood of any owner of Stansted Airport proceeding with a planning application for a second runway, to the timetable originally proposed when the Commission considered this issue, has reduced since autumn 2008. The CAA considers that the net impact of such a delay would be to defer at least some of the projected SG2 preliminary spending in Q5 by up to several years, and potentially lead to no such expenditure being incurred in Q5 (if the airport owner were to set aside runway plans indefinitely). In principle, therefore, the CAA recognises that there could be a case, if one were constructing a price cap based primarily on a 'building block' analysis, for reducing the Q5 projected costs (and hence price caps) on account of this factor. The CAA notes that any such downward adjustment would be likely to fall within the range 0-1½ per cent of total airport charge revenues over Q5, and that given the inherent uncertainties surrounding SG2 development, a case could be made for adopting any point within or at the ends of this range, were a 'building block' price control to be applied. The CAA considers the impact of this potential case for a downward

³⁵ The deferral of this capital expenditure would reduce and/or defer the return on the projected investment, but not affect the return of the principal invested, which (under a 'building block' price cap) would normally only affect the price cap subsequent to the coming into operation of the second runway.

adjustment to a 'building block' price cap in its overall assessment at the end of this chapter.

(ii) Assessment of other factors affecting cost 'building blocks'

3.94 The following section considers the consultation responses and latest market evidence affecting forecast traffic, capital expenditure, operating expenditure, commercial revenues, cost of capital, and inflation.

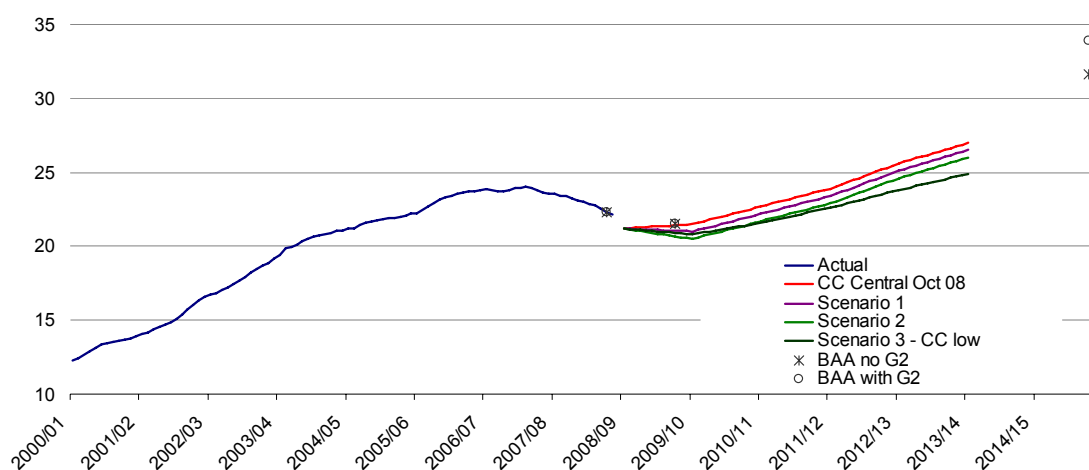
Traffic forecasts

3.95 In its December 2008 proposals, the CAA proposed two areas where the Competition Commission's traffic forecasts could be updated. The first was the current airline operations and publicly announced plans for Stansted, which could affect the forecasts for 2009/10. The second was changes in economic or oil price forecasts which could affect the forecast demand for the remaining years of the quinquennium.

3.96 The latest available information for Stansted indicates that it has served 22.2 million passengers in the year to January 2009, down 6 per cent on the year to January 2008. This suggests that the traffic total for 2008/09 will be slightly above the Commission's estimate of 21.2 million.

3.97 In mid February, BAA submitted further Stansted traffic forecasts for 2015 to the G2 planning inquiry, of 33.9 million passengers with G2 opening in 2015, and 31.6 million without G2. The latest traffic data, BAA's forecasts and the scenarios considered by CAA in its December proposals are shown in Figure 3-1 below.

Figure 3-1 Stansted passenger traffic, 12 month rolling average



Source: CAA, BAA

Notes: Scenario 1 = CC central -0.5mppa, Scenario 2 = CC central -1.0mppa, Scenario 3 = CC low forecast.

3.98 In its oral evidence, the SACC noted that airlines were initially affected by high oil prices in 2008, in response to which they reduced capacity in Winter

08/09 compared to the previous year. The SACC expected that traffic in Summer 2009 would be lower than in Summer 2008, but not to the extent that Winter 08/09 was lower than Winter 07/08. The SACC also currently thought that traffic in Summer 2010 was unlikely to be lower than Summer 2009, but a high degree of uncertainty affected any predictions this far ahead.

3.99 Further developments are also evident in the wider economic indicators considered by the Commission as background to its traffic forecasts. Table 3-1 shows how GDP and consumption growth forecasts for 2009 have all worsened since the Commission's report in October 2008 and the CAA's December 2008 proposals.

Table 3-1 UK economic growth and consumption forecasts for 2009

	In CC report		In Dec 08 doc		Latest forecasts	
	Date	Value	Date	Value	Date	Value
GDP						
IMF	April 08	1.7	Oct 08	-0.1	Jan 09	-2.6
Oxford Economics	June 08	1.7	Oct 08	-0.1	Feb 09	-2.7
Consensus Economics	June 08	1.3	Nov 08	-0.9	Feb 09	-2.6
HMT comparison of independent Forecasts	Aug 08	0.9	Nov 08	-0.9	Feb 09	-2.7
Consumption						
Consensus Economics	June 08	1.0	Nov 08	-1.2	Feb 09	-1.9

Source: HMT website, Consensus Economics

3.100 The table shows that economic forecasts have significantly deteriorated even since December 2008. Both the Bank of England³⁶ and the IMF³⁷ have recently predicted UK GDP contraction in 2009 followed by growth in 2010, albeit acknowledging more downside risk than upside risk in these forecasts. The IMF forecast UK GDP growth for 2010 of +0.2 per cent compared to Consensus Economics' February 2009 forecast of +0.6 per cent, either of which (for a year of 'recovery') would represent lower annual growth in UK GDP than any year between 1993 and 2008.

3.101 One major downside risk for the UK economy beyond 2009, and also for passenger traffic at UK airports, is the global nature of the current economic downturn. The IMF's prediction for world GDP growth of +0.5 per cent in 2009 would be lower than in any year since 1980, and the 2010 forecast of +3.0 per cent growth would be on a par with 2008, which was itself the lowest global GDP growth since 2001.

3.102 Of potentially more direct significance to Stansted's short haul traffic is GDP growth in the Euro area, which the IMF forecast at -2.0 per cent in 2009 and +0.2 per cent in 2010. In December 2008, the CAA noted that the pound had

³⁶ Inflation Report, Bank of England, February 2009

³⁷ IMF World Economic Outlook Update, 28 January 2009

fallen from around €1.40 in autumn 2007 to around €1.20 in November 2008. The exchange rate is currently around this level (though it has been lower).

- 3.103 The CAA also reviewed crude oil prices in December 2008, noting that they had declined significantly in both dollar and sterling terms since the Commission's report. Latest crude oil and jet fuel prices show further declines, with the average January 2009 dollar price for both commodities less than half the equivalent September 2008 prices. In sterling, the decline has been less steep, with jet fuel in particular only around three-quarters of its September 2008 level.
- 3.104 It is not straightforward to assess the effects of these developments in economic and operational factors on Stansted's likely traffic throughput for Q5. Lower jet fuel prices should reduce overall costs for airlines, but the contraction in the UK economy, coupled with a weaker Euro exchange rate will likely dampen UK demand for short haul leisure trips. Any possible stimulus to inbound travel due to a weaker pound in the short term therefore needs to be balanced by the effects of a general weakening of the economies of mainland Europe.
- 3.105 Whilst the DfT and others have modelled the effects of economic factors on overall passenger demand, their impact on traffic, particularly leisure traffic, at a single airport is more complex. Ryanair, in its oral evidence, commented that the business model of no frills airlines, prevalent at Stansted, required load factors to remain high, achieved through managing fare levels. This would imply that the effect of increased costs or reduced demand will be seen as airlines withdraw services, rather than through gradually declining traffic levels. It may also be that no frills airlines can benefit from demand from full service passengers at other airports 'trading down'.
- 3.106 On the other hand, the scale of the economic recession affecting the UK and Europe could have a significant effect. In Annex C of its reference to the Competition Commission, the CAA noted the difficulties of longer-term forecasting (10 years or more) and that, even over the shorter term of a single quinquennium, there was some evidence that traffic at secondary airports was subject to greater forecast uncertainty than that for an airport system as a whole, the more so given Stansted's position at the fringes of the London system.
- 3.107 In summary, the worsening current macroeconomic position has contributed to Stansted traffic declines in recent months. The worsening prospects for the economy since the Commission reported, notwithstanding sharp reductions in the oil price, are likely to have increased the probability that traffic at Stansted in Q5 will be less than that forecast by the Commission in its 'most likely' forecast. Moreover, whilst traffic in Q5 now appears more likely to be closer to the Commission's 'low' forecast than its 'most likely' forecast, that low forecast was made in very different economic circumstances and it is possible that traffic could be lower still.

- 3.108 In addition to evidence on passenger traffic forecasts, the CAA also exhibited and considered evidence on cargo and other non-passenger flight traffic trends in its December proposals, for the purposes of adjusting the Commission's overall airport charge revenue projections to arrive at the per passenger airport charge cap on passenger flights implied by the Commission's analysis. The CAA projected that airport charge revenues from non-passenger revenues would remain constant in real terms from 2008/09 across the Q5 period.
- 3.109 Since December 2008, it is apparent that global air cargo has experienced a very sharp decline in volumes. IATA reported at end January 2009 that global international cargo traffic had declined 22.6 per cent in December 2008 on 12 months previously, compared to a 4.6 per cent decline in passenger traffic over the same period. For the full year 2008, international cargo traffic was down 4.0 per cent while passenger traffic showed a modest growth of 1.6 per cent. The impact of global trends on the traffic prospects for an individual airport are clearly not direct nor necessarily of the same magnitude. Nevertheless, it would be reasonable to posit that Stansted would be exposed to similar overall demand factors, tending to depress the demand projections of cargo traffic, certainly in the early years of Q5, from the previous projections. In January 2009, cargo tonnage shipped at Stansted had fallen to around 13 million tonnes from a monthly average of around 18 million during 2008, a decline of over 25 per cent.
- 3.110 The CAA considers that there is now a greater downside risk for projections of airport charge revenue from non-passenger flights at Stansted in Q5 than that which the CAA adopted in its December proposals. The CAA has therefore examined the impact of a plausible downside scenario of reducing these projections by 10 per cent across Q5 as a whole. In a 'building block' calculation, such reductions would increase the NPV of revenues from airport charges on passenger flights by around 0.5 per cent. As with other macro-economic factors, the CAA considers the impact of this potential case for a marginal upward adjustment to a 'building block' price cap in its overall assessment at the end of this chapter.

Capital expenditure

- 3.111 In light of the evidence regarding current and prospective traffic at Stansted in Q5, the CAA has re-considered the whether any decline in traffic below that forecast by the Commission might warrant a revised SG1 capital expenditure programme, involving deferral or scaling back of some projects.
- 3.112 The CAA notes the following factors:
- the core programme agreed between the airport operator and the SACC had been stripped of the major projects which were most dependent on traffic growth for their justification;

- the resulting programme of smaller projects was more focused on the continuing operations of the airport, through incremental additions to airfield infrastructure, modest improvements to terminal facilities, replacement of parts of the baggage handling system, and replacement of life-expired assets. This was confirmed by STAL at the CAA's oral hearing in February 2009, in which the airport operator stated that there would be very few larger projects over Q5, and that the highest cost project would be the baggage system upgrade at £15 million;
- as a result, it appears to the CAA that much of this core programme is relatively unaffected by variations in traffic forecasts within the ranges considered by the Commission and the CAA subsequently;
- the pattern of expenditure on SG1 projects is projected to be fairly even over the Q5 period, so that if some projects were to be delayed and/or scaled back, this would be unlikely to alter materially the overall projected total of some £85 million for SG1 projects in Q5; and
- the impact of an incremental reduction in the forecast SG1 spend would not therefore be material in the context of the Commission's overall assessment of a 'building block' price cap.

3.113 In light of the above, the CAA concludes that there would appear to be no strong case for adjusting the Commission's own projections of SG1 capital expenditure in Q5 on account of the latest evidence on airport traffic growth over this period.

Operating expenditure

3.114 The CAA has, in examining the potential impact of downside risks to the Commission's traffic projections on its 'building block' price cap calculations, factored into those calculations the impact that lower traffic would have on operating expenditure, using the same elasticity factor as used by the Commission in its own modelling.

3.115 More specifically, the SACC and Ryanair in their submissions both raised concerns regarding:

- the level of airport air navigation service (ANS) charges and, in particular, the increase in charges on 1 April 2008; and
- the availability of service quality rebates to Stansted airport for poor service provided by NATS without corresponding payments to airlines.

3.116 In its report the Commission stated that after comparing ANS costs at Stansted with charges at other airports it had concluded that the costs included in BAA's contract with NATS were reasonable and so had been

included in its projections³⁸. In its December 2008 proposals, the CAA considered that, overall, the Commission's operating expenditure projections were a reasonable and appropriate basis for constructing a RAB-based price cap³⁹. It therefore tacitly accepted the Commission's projections for ANS costs for this purpose.

- 3.117 The CAA has investigated this issue further in light of the concerns raised by airlines. As far as the level of charges is concerned, on 1 April 2008 the arrangement for the recovery of ANS costs was changed by the Government from a system of direct charging of users by NATS to recovery by the airport operator as part of its overall scheme of airport charges. However, this also coincided with the coming into effect of a wholly new contract between BAA and NATS for the supply of ANS services at BAA's airports, including Heathrow, Gatwick and Stansted. BAA consequently revised the levels and structure of ANS charges at the three London airports to reflect the terms of the new contract. Following consultation with airlines this resulted in both airport-specific pricing, compared to the previous common-rating of charges at the three airports, and charges more closely linked to the drivers of ANS costs, namely aircraft movements rather than the previous exclusive measure of aircraft weight. Given these significant developments, the CAA considers it not surprising that the changes in level and structure of ANS charges have affected airlines differently both across and at the London airports.
- 3.118 Since 1 April 2008, ANS charges levied by BAA at its airports have been treated as regulated airport charges and consequently fall within the scope of the price cap applying to airport charges generally at each of the London airports. The CAA is satisfied that the airports, including Stansted, have set their airport charges in a way that is consistent with the relevant price control condition. The CAA also notes that the Commission did not make a public interest finding in respect of Stansted's general airport charges that were applied from 1 April 2008, despite requests from Ryanair to do so.
- 3.119 On the second issue - service quality rebates from NATS to BAA - the airlines had been led to believe that the new contract between BAA and NATS provided for such rebates at Stansted. The CAA considers that they are mistaken in this belief as the contract, details of which have been provided to the CAA on a confidential basis, does not, in fact, include any financial penalties at Stansted.
- 3.120 In the light of this assessment, the CAA has not made any adjustment in respect of ANS to the operating expenditure allowance adopted by the Commission in its recommendations or to the design of the price control.

³⁸ CC October 2008, Appendix H, paragraph 132

³⁹ CAA December 2008, paragraph 3.71

Commercial revenues

- 3.121 The CAA has, in examining the potential impact of downside risks to the Commission's traffic projections on its 'building block' price cap calculations, factored into those calculations the impact that lower traffic *per se* has on retail revenues, using the same elasticity factor as used by the Commission in its own modelling.
- 3.122 BAA's challenge to the CAA is that the Commission's retail and car parking revenue projections were not made with an understanding of the airport market, and failed to take into account that BAA had already included measures designed to boost yields in the projections which it provided to the Commission. The Commission's additional revenue projections were (in BAA's view) thus effectively double-counting. BAA argued that to achieve an additional £19 million on commercial revenues over Q5 posited by the Commission would be 'frankly ... unattainable'.
- 3.123 The CAA considers the following factors to be relevant to its assessment of this issue:
- BAA's claim that the Commission's consultants did not understand the airport market does not look strong in light of the fact that this team from DTZ (previously Donaldsons) advised the Commission and the CAA at the Q4 and Q5 Heathrow and Gatwick reviews;
 - when pressed by the CAA on the revenue projections at the February oral hearings, noting that the disputed £19 million was less than 4 per cent of the projected total commercial revenues over Q5, BAA reiterated its position about the Commission double-counting BAA's own 'stretch' targets with DTZ's 'stretch' targets;
 - since the Commission reported, and even since the CAA issued its December proposals, the prospects for the UK economy have worsened. The CAA noted in December that this downturn could make achieving projected retail revenues more challenging than hitherto, but that the Commission's projections were still within reasonable bounds;
 - the current macro economic downturn will adversely affect overall consumer demand and hence overall retail spending in Q5, compared to the macro prospects at the time that the Commission undertook its analysis. One cannot read across from this macro factor to the projections of retail revenues at Stansted airport, given the idiosyncrasies of airport retailing, and within that the location-specific factors affecting passenger demand for retail at Stansted and the location-specific opportunities for the airport operator to seek to grow retail revenue. However, it appears unlikely that Stansted retail revenues would be completely insulated from the broader recessionary impact on consumer spending. Hence, one could

reasonably conclude that there was now greater downside risk on the Commission's retail revenue projections; and

- were BAA's own projections used as a downside estimate in a 'building block' price cap (i.e. stripping out the additional £19 million of retail revenues posited by the Commission), then this would increase the NPV of projected maximum airport charge revenues over Q5 by 2.6 per cent.

3.124 The CAA considers that, given the variance around any airport retail revenue projection, the Commission was acting well within the bounds of informed regulatory discretion to conclude as it did on the higher projections for Stansted in Q5. In doing so, the Commission was informed by professional advice from specialist consultants which had experience of providing similar advice to the Commission and the CAA in the course of previous price control reviews. The CAA recognises that there is now somewhat greater downside risk to the Commission's projections, the extent of which is uncertain. On one assumption (outlined above) a resulting downward adjustment could increase total airport charge revenues over Q5 by up to 2½ per cent. The CAA considers the impact of this potential case for a marginal upward adjustment to a 'building block' price cap in its overall assessment at the end of this chapter.

3.125 The SACC raised concerns that the Commission may have erred in subtracting from the projected retail revenues to be included in the single till, for the purposes of calculating the Q5 price cap, too much retail revenue ascribed to the terminal expansion projects which were not included in the capital expenditure projections. The CAA has re-examined the Commission's analysis and supporting consultancy study, in light of these concerns. In the CAA's view, the evidence presented in the Commission's report and appendices supports the conclusion that the Commission's adjustment was reasonable in principle and (as reported by the Commission) appears to have been correctly implemented in practice. The SACC's consultation response does not provide any further evidence on this point. The CAA therefore concludes that the Commission's conclusion in this respect was reasonable and, as part of its broader judgement on commercial revenues in Q5, could be relied upon as a reasonable input to a 'building block' price cap analysis.

Cost of capital

3.126 The CAA's December 2008 proposals, based on the results of the Commission's analysis of the components of the weighted average cost of capital for Stansted airport in Q5, are shown in Table 3-2 below.

Table 3-2 The Commission's estimates of the components of WACC

Per cent	Low	High
Gearing	50	50
Pre-tax cost of debt	3.4	3.7
Risk free rate	2.0	2.0
Market return	5.0	7.0
Equity risk premium	3.0	5.0
Equity beta (number)	1.00	1.24
Post tax cost of equity	5.00	8.20
Taxation	28	28
Pre tax cost of equity	6.94	11.39
Pre tax real WACC	5.20	7.54

Source: Commission Table 21

3.127 The Commission recommended, and the CAA proposed in December 2008, that the appropriate cost of capital at Stansted was 7.1 per cent, but recommended that the CAA continue to monitor the financial markets and any effect, in particular, on the variable element of the cost of debt. As noted in the December 2008 proposals, the CAA considered that the Commission's cost of capital estimate was a reasonable and appropriate basis for constructing a RAB-based price cap. A price cap set on a different basis such as the long-run average incremental cost might warrant a different cost of capital.

3.128 In line with the Commission's recommendation, the CAA has continued to monitor the cost of debt, observing the two benchmarks used by the Commission – A-rated and BBB-rated corporate debt. The floating rate debt assumption made by the Commission was that A-/A3 rated debt would provide a yield of around 6.5 to 6.8 per cent. This was based upon the A-rated benchmark and the BBB-rated benchmark. These benchmarks have moved slightly since the Commission cut off its data (12 September 2008).

Table 3-3 Redemption yields on benchmark A and BBB-rated debt

Per cent	A-rated	BBB-rated
Unweighted average of daily data		
1 May 2008 to 12 September 2008	6.35	6.82
13 September 2008 to 27 February 2009	6.40	6.98
Increase (percentage points)	0.05	0.16
As at 12 September 2008	6.27	6.82
As at 27 February 2009	6.34	6.85
Increase (percentage points)	0.07	0.03

Source: DataStream

3.129 The Commission's recommendations assumed that throughout Q5 50 per cent of Stansted's debt would track market rates, while the remaining 50 per cent would be existing fixed rate debt. The slight increase in the yields suggests that there may be upward pressure, in the region of 3bp to 16bp, on the cost of the debt for the element of the notional debt portfolio which the

Commission assumed would track market rates (existing floating rate and future debt to be issued in Q5).

- 3.130 Where inflation is relatively stable, changes in nominal yields will provide a reasonable indicator of changes in the underlying real cost of debt. However, this may not be so where inflation (and associated inflation expectations) change significantly. A relatively constant nominal cost of debt may mask an increase in the real cost of debt if inflation expectations amongst investors are falling. The CAA has, therefore, considered the effect of changing inflation expectations on deducing a real cost of debt from nominal market yields.
- 3.131 The CAA has considered two sources of data⁴⁰. Evidence from the quarterly Bank of England Inflation Reports from summer 2008 to spring 2009⁴¹ suggests that there has been a reduction in inflation expectations for the period mid 2009 to end 2011 in the region of 50bp. Inflation expectations have also been inferred from the difference in yields on index-linked gilts and nominal gilts. These data suggest that since the Commission cut off its data (12 September 2008), the reduction in inflation expectations for the next five years is somewhat greater (over 100bp), declining to around 80bp for ten years and around 60bps for 20 years – a blended average of these numbers would be relevant to the consideration of the Q5 cost of capital, on the assumption that the company's debt maturities were in the range 5-20 years. This evidence suggests the real cost of debt may have risen all other things being equal. The CAA has not sought to extract a precise estimate of the change in investors' inflation expectations from these data, but nevertheless concludes that the evidence suggests that the reduction in inflation expectations relevant to estimation of the cost of debt for the next five years might be in the region of 50 to 100bp. Such a change would equate to an increase of approximately 50 to 100bp in the real cost of the debt for the element of the notional debt portfolio which the Commission assumed would track market rates.
- 3.132 easyJet submitted data showing the nominal yields on A- and BBB-rated corporate bonds had changed in the region of minus 19bp to positive 15bp, since the CAA's December proposals.
- 3.133 BAA submitted evidence that it said showed an increase in the cost of debt since September 2008. The evidence was based on primary issuance of investment-grade debt in Europe. The analysis showed yields to maturity at issue between the first eight months of 2008 and the period since September 2008. BAA suggested that the evidence showed the yields had increased, across the four sectors selected, for companies selected and across investment grade ratings. BAA noted that this evidence points at a significant increase in the cost of raising new debt faced by corporate across relevant

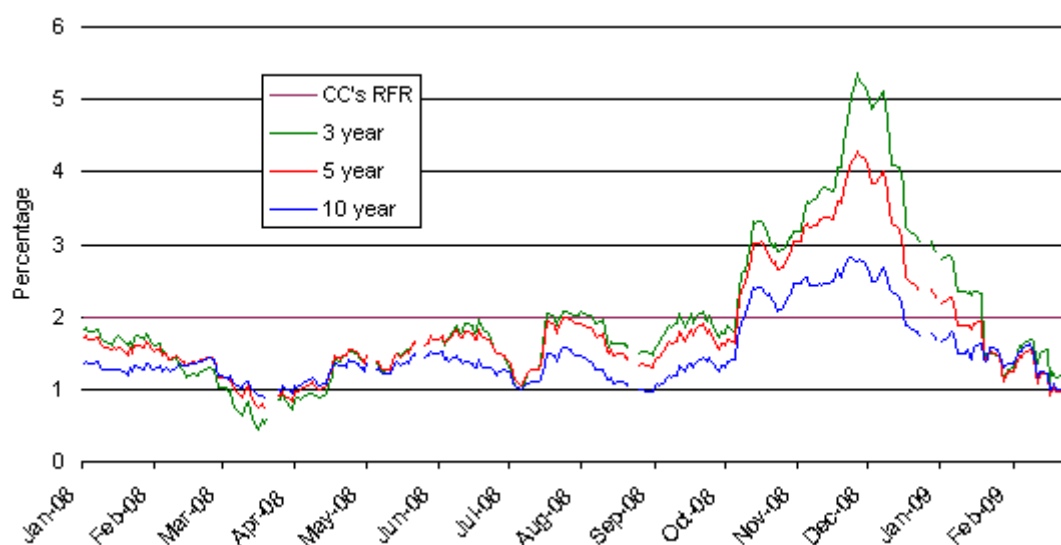
⁴⁰ taking a cut off of 27 February 2009 for data

⁴¹ for example, comparing Chart 5.4 in the February 2009 report with the equivalent in August 2008

sectors. However, BAA did not quantify the impact of this new issuance evidence on the cost of debt assumption.

- 3.134 The CAA recognises that there is upward pressure on the real cost of new debt issued in Q5 and existing floating rate debt being driven by changing inflation expectations (may be in the region of 50 to 100bp) and a small, but positive, increase in the nominal yields (up to 16bp). Given the Commission's assumptions that new debt issued in Q5 and existing floating rate debt represents 50 per cent of the debt portfolio and gearing is 50 per cent, a formulaic approach would suggest the combined impact of the upward pressure on the WACC would be in the region of 13 to 29bp. Given the judgement required, a point estimate from within this range would be spuriously precise, and therefore the CAA has modelled the impact of a WACC of 7.2 per cent (10bp increase compared to the December proposal of 7.1 per cent) and 7.4 per cent (30bp increase).
- 3.135 The CAA has considered the arguments adduced by BAA for increasing the allowed cost of equity, through increasing the equity risk premium (ERP), risk-free rate (RFR) and/or the beta. However, it is not clear that these arguments do suggest that the Commission's assumptions can no longer be regarded as reasonable. In respect of the ERP and the RFR, the Commission took a very long-run approach to estimating the cost of equity. Moreover, if cost of equity capital had recently increased due to increased volatility and uncertainty in the equity markets, this would not necessarily have a material impact on the very long-run cost of equity.
- 3.136 The Commission based its estimate of the RFR on yields on index-linked gilts (ILGs). The CAA has monitored yields on ILGs as set out in Figure 3-2 below.

Figure 3-2 Redemption yields on Index Linked Gilts



Source: Bank of England website; data up to 27 February 2009

- 3.137 The CAA notes that in late 2008 yields on ILGs of all maturities increased significantly before falling back in early 2009 to levels similar to early 2008. It is difficult to believe that such volatility confined to a short period of time reflects actual changes in the short run RFR, let alone the longer-run RFR. Yields from this period therefore may not be a good indicator of the RFR to use in the very long run cost of equity. In this context, the CAA notes that the Commission also observed that the return on the market was unaffected by shorter-term fluctuations in the RFR. Moreover, even if the CAA were to take into account this recent period, average daily yields over the past year are in the region of 2 per cent or less⁴².
- 3.138 BAA argued that the marginal nature of Stansted with respect to demand in the London region meant that it was more exposed to volume risk than other airports in London, and as such was likely to have seen an increase in relative risk, hence beta, since the beginning of the market turmoil. The CAA notes, however, that it is not clear that Stansted's recent performance, in light of the economic conditions, reveals a change in equity investors' perspective of its exposure to systematic risk since the Commission undertook its analysis.
- 3.139 The CAA has considered the SACC's view that the CAA should align the Stansted WACC with the lower estimate for Gatwick in the CAA's Q5 price control decision, but is not persuaded that such an approach would be justified, or indeed that it suggests that the Commission's assumptions in relation to the cost of capital fall outside a reasonable range. In reaching this position, the CAA notes the extensive work the Commission undertook to understand the differences in risk that Stansted faced compared to Gatwick and recent financial market information. In light of this evidence, the Commission concluded that Stansted faced greater systematic risk than Gatwick, it would be appropriate to adopt a higher credit rating assumption and, therefore, Stansted's cost of capital was greater than that of Gatwick.
- 3.140 The long run cost of equity used in the WACC by the Commission therefore continues to appear to be reasonable.
- 3.141 BAA noted that in its view, the A- credit rating assumed by the Commission was not achievable with the cost of capital assumptions. The CAA modelling showed that reducing gearing improved the two key credit metrics (net debt/RAB and interest cover) without materially affecting the cost of capital. In respect of raising new finance, the CAA notes the relatively low levels of new finance required during Q5 because of forecast capital expenditure included in the building blocks, and the assumption that the notionally financed Stansted would have accessed and will continue in Q5 to access, the debt markets at regular intervals throughout the economic cycle, rather

⁴² Average daily yields (year to 27 February 2009) were 2.05 per cent, 1.86 per cent and 1.52 per cent for 3-,5- and 10-year ILGs respectively

than re-financing a significant proportion of its debt in a single, large issuance.

- 3.142 Most recently, the CAA notes that the Bank of England embarked in early March 2009 on a new policy of 'quantitative easing', through a substantial programme of purchasing gilts and corporate bonds, with the aim of increasing the rate of monetary growth and, thereby, the rate of growth of nominal spending. This new policy could result in lower yields on gilts and corporate bonds, offsetting to some degree the upward pressures identified in the assessment above. Given the significant uncertainty, though, surrounding the specifics of implementation and the impact of this policy on the projected costs of corporate debt and Government gilts over the course of Q5, the CAA has not sought to quantify these effects.
- 3.143 Overall, the CAA considers that, following the Commission's recommendation to review developments in the debt markets since October 2008, there is some evidence to suggest upward pressure on the cost of debt and, therefore, on the Commission's point estimate of the WACC of 7.1 per cent over Q5 for the purposes of constructing a 'building block' price cap. The CAA examines later in this chapter the potential impact on the Commission's 'building block' price cap analysis of the upside risk now identified for the cost of capital estimate by incorporating two sensitivities, costs of capital of 7.2 per cent and 7.4 per cent, as derived in the preceding discussion on evidence relating to the cost of debt.

Inflation

- 3.144 The previous section noted the impact of changes in investors' inflation expectations when using historical nominal market data to estimate a real cost of debt. This section considers the impact of changes in current and prospective inflation on fixing a monetary value for the first year price cap.
- 3.145 It has become increasingly apparent in the months since the Commission reported that the UK, along with other economies, is experiencing a profound financial and economic shock. This has led to an unprecedented fall in current and prospective inflation, and a radical reduction in official interest rates, from 5 per cent in early October 2008 to 0.5 per cent in March 2009. In the words of the Governor of the Bank of England: 'The prospects for economic growth and inflation remain unusually uncertain, not least because of the extraordinary events of the past few months. The [Monetary Policy] Committee judges that the balance of risks to the path for GDP is very much to the downside, reflecting in large part uncertainty about when lending and confidence will recover. But the risks to inflation are more broadly balanced, reflecting the possibility that the sharp depreciation of sterling may push up on inflation by more than the Committee expects'⁴³.

⁴³ Governor of the Bank of England, 11 February 2009

- 3.146 In light of the recent declines in inflation outturn and projections, the CAA has revisited the assumptions underlying the Commission's analysis. In doing so, the CAA is conscious that the current heightened economic uncertainty makes it much more difficult to interpret latest inflation data. The Commission assumed Retail Price Index (RPI) inflation of 4.8 per cent for 2008/09 on 2007/08 and 3 per cent for 2009/10 on 2008/09. The latest outturn data for the first ten months of 2008/09 show annual RPI (first 10 months 2008/09 on same period 2007/08) to be ~3.6 per cent. Including projections for inflation for the last two months of 2008/09 would tend to lower the projection for the year as a whole (down to ~3 per cent), given that inflation rates are currently falling sharply. The latest Treasury survey of independent forecasts reports latest annual RPI inflation forecast for Q4 2009 on Q4 2008 to be minus 1.9 per cent⁴⁴.
- 3.147 Compounding the latest outturn and forecast data points would give RPI inflation of around 1 per cent from 2007/08⁴⁵ (the base year for the Commission's building block analysis) to 2009/10 (the first year of Q5), compared to 7.9 per cent using the Commission's own projections, a difference of around 7 per cent from the Commission. The impact on the price cap itself would be moderated somewhat by the use of lagged RPI inflation outturn data⁴⁶ to derive the 2010/11 price cap from the 2009/10 cap – the fact that inflation is forecast to be around negative 2½-3 per cent for this period would tend reduce the effective difference. The net result is that, if no adjustment were made for latest evidence on inflation, then the emerging differential between the Commission's inflation assumptions and the currently available outturn and forecast data could lead to the price cap allowing for airport charge revenues over Q5 as a whole to be around 2½ per cent higher in real net present value terms than the Commission projected. However, there remains considerable uncertainty around the prospects for inflation in general over the Q5 period.

(iii) Assessment overall of factors affecting the Commission's 'building block' analysis

- 3.148 In the preceding sections, the CAA has discussed at some length the various challenges from airlines and BAA to the Commission's 'building block' analysis and the CAA's assessment thereof, alongside the potential implications of the latest market evidence which is now available to the CAA. In this concluding section, the CAA illustrates the likely direction and potential magnitude of a number of possible adjustments to the Commission's 'building block' price cap analysis.⁴⁷ From this, the CAA sets out its conclusion on

⁴⁴ Forecasts for the UK economy, A comparison of independent forecasts, HM Treasury, February 2009

⁴⁵ 3 per cent for 2008/09 on 2007/08 and -1.9 per cent for 2009/10 on 2008/09

⁴⁶ RPI August 2009 on August 2008, projected at -2.8 per cent (based on historic data and latest Treasury survey of independent forecasts).

⁴⁷ It is not possible to infer from the results of this analysis how the Commission might have modified its overall recommendation to the CAA in light of the additional evidence that is now available. Rather, this analysis repeats the 'building block' calculation undertaken by the Commission to support its recommendation. In light of the additional evidence now available the Commission might have modified

whether the Commission's recommended price caps remain a reasonable regulatory judgement consistent with the CAA's statutory objectives.

- 3.149 The CAA has modelled the quantitative impact of a number of plausible adjustments to the input assumptions which the Commission used to calculate its 'building block' price cap. The results of this modelling are set out in Table 3-4. For ease of exposition, the CAA has focused on changes in the net present value of airport charge revenues from passenger flights over Q5 as the single metric used to compare the impact of alternative input assumptions. This abstracts from the profile of airport charge caps over Q5 or the particular price cap in a given year, both of which would (under a 'building block' approach) be variables to be determined in light of the overall projected NPV of airport charge revenues.
- 3.150 The CAA does not regard this modelling as necessarily sufficient to determine precisely how individual building blocks would be adjusted to take into account the new information and analysis discussed in the preceding sections of this chapter. In particular, the modelling does not include an estimation of the probabilities of the various scenarios that have been modelled in order to derive a more precise estimate of the likely overall impact. Moreover, they may not represent the only, or even the most likely, scenarios. And the summation of the positive and negative impacts does not take into account any second order interactions between the different building blocks. Nevertheless, the results do serve to illustrate the likely direction and plausible magnitude of the potential effect that the new information and analysis since the Commission concluded its modelling could have on individual building blocks.

its overall approach in a number of ways, such as through the profiling of revenues between Q5 and Q6, as was recommended for Stansted in Q4.

Table 3-4 Summary of modelling of alternative assumptions⁴⁸

Factor	Plausible direction of change	Scenario modelled	Impact on Q5 maximum allowed airport charge NPV versus the CAA's December proposals (%)
Passenger traffic	Reduction	Traffic lower by 1mppa than CC projection	+6½
		CC low traffic case	+9
Non-passenger traffic	Reduction	10% reduction of CAA projection of Q5 airport charge revenues from non-pax flights	+½
RPI inflation	Reduction	Latest outturn and independent forecasts for 2007/08-2009/10: 1% compound versus CC projection of 7.9%	-2½
Cost of capital	Increase	+10 basis points increase (based on higher debt costs), leading to WACC of 7.2% ⁴⁹	+½
		+30 basis points increase (based on higher debt costs), WACC of 7.4%	+1½
Commercial revenues	Reduction	CC projections less £19m disputed by BAA as proxy for worsening consumer environment	+2½
Q5 SG2 preliminary expenditure	Reduction	Defer non-blight costs by 2 years	-½
		All SG2 Q5 spend excluded	-1½
Sum ⁵⁰ of factors increasing CC price cap			+10 to +14
Sum of factors decreasing CC price cap			-3 to -4

3.151 Table 3-4 shows that the macro-economic downturn would likely:

- put upward pressure on the cost of capital;
- put downward pressure on commercial revenues; and
- reduce the base of passenger and non-passenger traffic from which allowed revenues would be assumed to be recovered,

⁴⁸ The NPV impact is measured as the change in Stansted Q5 revenues if the adjustment to the 'building block' were made but that all of the forecasts underlying the December 2008 proposals proved to be correct and that the airport operator priced to the cap.

⁴⁹ In adjusting the cost of capital estimate the CAA has also adjusted the discount rate similarly, to derive internally consistent NPV calculations; not to do so would result in higher NPV impacts.

⁵⁰ The factors exhibited in this table have been summed to illustrate the overall positive and negative impacts on the overall maximum projected levels of allowed airport charge revenue in Q5 were a strict building block approach to be adopted. This analysis abstracts from any second order interaction between the factors which have been modelled.

and that these effects would significantly outweigh the impact of taking into account more up-to-date information on the RPI. This picture does not change materially even if the allowed return on the whole of the forecast £40 million associated with preliminary expenditure were to be disallowed. It follows that were a 'building block' price control to be set by making adjustments for the new evidence and analysis that has come to light since the Commission conducted its analysis and made its recommendations (in the relatively simplistic way described above), it could be argued that such a price control would be higher – perhaps significantly so - than that proposed by the Commission⁵¹.

3.152 However, it is not clear that the CAA can automatically infer from these results that a regulatory authority choosing to set a price control based on 'building blocks' would necessarily decide – in the light of all of the available evidence – to revise the price control upwards. For the same reason, it is not clear whether the Competition Commission – were it hypothetically able to provide up-to-date recommendations to the CAA – would choose to recommend a looser price cap than it proposed in October 2008. There are several reasons for this:

- first, as noted in paragraph 3.150, the above analysis is based on scenarios that are illustrative only, and qualified as set out in paragraph 3.150. Selecting different scenarios, attaching different relative probabilities to them, and considering second order interactions between them might well have delivered different results, which might have different – possibly less marked – consequences for a 'building block' price control;
- second, there is a high degree of uncertainty around the effects that new information and evidence would have on individual building block assumptions. This uncertainty – which stems partly from the fact that new evidence has emerged in the relatively short period since the Commission reported to the CAA – might itself argue against fully reflecting in a revised building block price control the effects resulting from the latest information and evidence;
- third, it also seems reasonable to suppose that the Commission – in arriving at its October 2008 recommendations – would have been conscious of the need to apply price controls that would be resilient to a range of different outturn scenarios. The CAA notes, for example, that the Commission, despite reaching its conclusions in the midst of the economic downturn, did not suggest that the CAA continue to keep assumptions about commercial revenues under review;

⁵¹ In referring to the price control proposed by the Commission, the CAA is referring to the Commission's recommendations after adjusting for the omission of non-passenger revenues, i.e. the allowed revenues implicit in the CAA's December 2008 proposed price control.

- fourth, even if the view was taken that the new evidence, and updated ‘building block’ assumptions, implied that the revenues that Stansted should be permitted to recover should be increased, a regulatory authority applying a RAB-based price control approach with reference to the duties set out in section 39 of the Airports Act, might not choose mechanistically to loosen the price control for the forthcoming five year period. Rather, a regulatory authority, in these circumstances, might instead decide that it would be more appropriate to propose the deferral of revenue to a future period, especially if that regulator faced evidence suggesting that the regulated company might be unable to charge up to the level of the price control at the level of traffic assumed (as appears currently to be the case with Stansted, as discussed in chapter 4). Indeed, this sort of approach was recommended by the Commission (and subsequently adopted by the CAA) in establishing the Stansted Q4 price control; and
- more generally, it is possible that a regulatory authority might – in these circumstances – place weight on the fact that a mechanism exists within the Airports Act for the airport operator to request that the CAA consider amending the price cap, thereby providing a ‘safety valve’ in the event that the price control proved in due course to be set at too tight a level such that it needed to be modified prior to the next periodic price control review.

3.153 For these reasons, the CAA considers that it is not clear that a regulatory authority applying a ‘building block’ price control would necessarily adjust the Commission’s price profile to reflect new information on the individual cost, revenue and traffic building blocks. Accordingly, the CAA continues to consider that the price caps as proposed in its December proposals and reflecting the Commission’s recommendations adjusted specifically to distinguish between price caps on passenger and non-passenger flights (as set out in Table 3-5 below) fall within the range of price caps that could be reasonably recommended by a regulatory authority applying a ‘building block’ methodology against the objectives set out under section 39 of the Airports Act.

Table 3-5 CAA’s proposed Stansted Q5 price control

Passenger flights:					
Proposed price cap £/passenger	2009/10	2010/11	2011/12	2012/13	2013/14
2009/10 prices	6.53	6.53	6.63	6.74	6.85
Increase in price cap: retail price inflation plus X%		RPI+0%	RPI+1.63%	RPI+1.63%	RPI+1.63%
Non-passenger flights:					
Airport charges for landing and parking to be no higher than the equivalent charges for a comparable passenger aircraft					

3.154 Against this background, the CAA considers that it is appropriate to conduct an assessment of this price control profile against its statutory objectives, in

light of the evidence and arguments put forward by respondents and the new information now available. This assessment is set out in chapter 4.

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4. Assessment of proposed price caps against the CAA's statutory objectives

Introduction

- 4.1 This chapter considers the CAA's assessment of the price cap profile proposed in December 2008 – and emanating from the assessment of the individual 'building blocks' contained in chapter 3 - against its statutory objectives, in light of the responses to that assessment and new evidence received since then.
- 4.2 This chapter is structured in five main sections. The first presents a short summary of the CAA's previous analysis of how the price cap profile proposed in December 2008 is best calculated to meet the CAA's statutory objectives. This is followed by a summary of respondents' views. The third section presents the CAA's assessment of the material provided by respondents. The fourth section considers the extent to which new evidence impacts upon the assessment that the CAA undertook in December 2008 of the proposed price cap. This is followed by a summary.

CAA's December 2008 proposals

- 4.3 In December 2008, the CAA set out its view that its statutory objectives imply that it should exercise its function to set a price cap in a manner that leads to appropriate prices, service quality, investment and efficiency at both Stansted Airport and other UK airports (to the extent that such airports, and their users, are affected by the Stansted price controls).
- 4.4 The CAA also noted the Commission's statement that its review '... was only concerned with the specific period of Q5' and that the prospects for long-term competition '...were not relevant for the Stansted review'.⁵² The CAA stated its view that this focus on Q5 alone was not appropriate and that, whilst the current price control review related to the caps that would apply during Q5, the factors which the CAA was required to consider in discharging its statutory duties were not limited in time to Q5; they required the CAA also to consider those factors in relation to subsequent periods.
- 4.5 The CAA also argued that there were three particular challenges, previously identified in the April 2008 reference to the Commission, that remained relevant to setting the price control on Stansted's airport charges: the uncertainty in the rate of growth of demand at Stansted; the 'lumpiness' of investment contemplated at the airport; and the existence of constraints on price and service at Stansted arising both from competition from non-BAA airports and from the application of price controls on Heathrow and Gatwick airports.

⁵² CC October 2008, paragraph 3.9

- 4.6 In respect of the third of these challenges, the CAA noted the divergent views about the strength of competition faced by Stansted but argued that the more relevant issues to the setting of price caps at Stansted were the extent to which Stansted had impacts on other airports; and the degree to which regulation could affect the sustainable development of competition over the long-term. As a result, the CAA also argued that BAA's initiation of the sale of Gatwick Airport, and the potential for further divestments following the conclusion of the Competition Commission's market investigation, underlined the importance of the CAA regulating Stansted in a way that facilitated, and did not crowd-out, the development of competition.
- 4.7 In order to assess the possible price cap profiles against its statutory duties, the CAA considered how the three profiles (referred to as option A, B and C⁵³) identified earlier in the December 2008 proposals would affect prices, service quality and investment at both Stansted and other UK airports, and the extent to which these impacts were best calculated to meet the CAA's statutory objectives.

Price impacts

- 4.8 In respect of the impacts on prices, the CAA argued that none of the three options raised significant concerns that they would result in prices at Stansted that would: expose users at that airport to unreasonable charges; undermine the efficient, economic and profitable operation of the airport; or discourage efficient investment. However, the CAA noted that there was a risk that the price cap options could artificially constrain prices below the level that would be expected in a well-functioning airport market, with detrimental consequences for operations, profitability and investment at other airports. The CAA argued that Option A, with its flat profile throughout Q5, would be at most risk of having these effects, particularly towards the end of Q5 when demand growth, and increasing scarcity, would be expected to put upward pressure on the competitive price level.
- 4.9 In support of these views, the CAA referred to a number of measures of forward-looking average cost. In particular, the CAA referred to the two estimates presented by the Competition Commission: an estimate of long-run average incremental cost (LRAIC) based on the results of the work of its consultants, ASA, of £7.80 per passenger; and an estimate of average replacement cost of £6.60 per passenger (both in 2008 prices). The CAA reviewed these estimates and produced updated estimates of these values of £6.70 and £6.30.⁵⁴ However, the CAA argued that these estimates were likely to represent a conservative estimate of average incremental costs, in part due to the use of the current average cost of capital, rather than the cost of capital that would apply to an incremental project.

⁵³ These profiles were set out in Table 4-4 of the December 2008 proposals document.

⁵⁴ Including a downward adjustment of £0.30 per passenger to account for expected revenues from non-passenger aircraft.

- 4.10 The CAA supported its views by reference to the strong evidence that prices charged at Stansted impact upon the level of charges set at other UK airports, notably at Luton, and explained how it could therefore be expected that price caps at Stansted would have impacts on a broader set of airports.

Service quality impacts

- 4.11 The CAA observed that the service quality rebate scheme would ensure that the consistency between the price control and the reasonable interests of users in respect of service quality and that the consistency between the Commission's recommendations on the price cap (as adjusted) and on service quality limited any concerns regarding the efficient, economic and profitable operation of Stansted.
- 4.12 Further, the CAA argued that it was unlikely that the price-service combination implied by the price control (under each of the three options) and SQR regime would have an adverse impact on other UK airports. Rather, they should encourage Stansted to raise service quality levels towards those of competing airports, something which would be expected to occur in a well-functioning market.

Investment impacts

- 4.13 In December 2008, the CAA repeated its concerns that where price caps – and therefore prices – are set by reference to historical (and expected) capital expenditure, as in the case of RAB-based regulation, the airport operator can have an artificially strong incentive to build big, and build early, albeit that this incentive is attenuated by the risk that the regulatory authority might prohibit excessive capital expenditure from being rolled into the RAB. The CAA also explained that the presence of this form of regulation might also distort the incentives faced by airlines – particularly those with a strong presence at the airport – to support certain development proposals, as the funding of airport development will put upward pressure on the price cap and prices paid. The CAA presented additional analysis, in a Supporting Paper⁵⁵, that explained how these distortions could arise and also presented evidence in its proposals document that indicated the potential materiality of these effects. However, the CAA also argued that the impact of these distortions would depend upon a range of factors, including the scale of the projects and the extent to which the projects would deliver benefits to the existing users of the airport.
- 4.14 In this respect, the CAA argued that in the case of the SG1 programme, the distortions of the 'building block' approach were relatively limited which, taken together with the focus of the SG1 programme on maximising the use of the existing runway, provided sufficient comfort that the project would be consistent with the CAA's statutory objectives.

⁵⁵ Supporting Paper to 'Stansted price control review – CAA's price control proposals', CAA, December 2008

- 4.15 The position was somewhat different in respect of the SG2 programme. The CAA noted that the cost of this project was large relative to the existing RAB, that it would deliver a substantial increase in the capacity of the airport and have a substantial and long-term impact upon the supply-demand balance in the South East. As a result, the CAA argued that there was the potential for the application of RAB-based, 'building block' price cap regulation at Stansted to distort airport investment incentives, by encouraging the airport operator to bring forward SG2 investment too early, to over-specify projects or to provide them at too high a cost. The CAA noted that it had taken steps to gain some comfort that the project was not being brought forward ahead of demand, by asking BAA to set out the commercial business case for SG2, and could take further steps to subject the project to additional scrutiny.
- 4.16 However, the CAA argued that these regulator-led approaches were clearly second best to relying on competition and commercial negotiation to determine investment outcomes at Stansted. The CAA also explained that whilst regulators might be reasonably well-placed to provide the necessary review of relatively small projects – such as SG1 – it seemed likely that the challenges faced by a regulator taking decisions (within a RAB-based framework) about larger, and more controversial, projects will be significantly greater. This task was further complicated by the need to assess the impact of SG2 upon the operation of and investment at other UK airports, and, more generally, the development of competition in the UK airport market. The CAA argued that a particular concern, relevant to its statutory objectives, was that premature or over-specified investment at Stansted might 'crowd-out' investment – including incremental investment to make the best use of existing capacity – at other airports, upon which users could place greater value.
- 4.17 The CAA noted the recommendation of the Competition Commission that consideration of the SG2 programme be deferred and be considered either at the Q6 price control review or at a mid-quinquennium review during Q5. However, the CAA explained its concern that the Commission's recommendations would imply an expectation that the SG2 project would be remunerated through a RAB-based, 'building block' price cap calculation. Such an expectation would be likely to affect the airport operator's willingness to engage effectively with its current and prospective customers about the specification and funding of new investment, whilst also distorting the incentives faced by the airlines at Stansted.
- 4.18 As a result, the CAA argued that an approach to SG2 that led to an expectation of continued application of the 'building block' methodology could have adverse effects on outcomes both within Q5 and beyond, and could adversely affect timely investment at Stansted and other UK airports and the reasonable interests of users.

4.19 Mindful of the potential for an expectation of a continued RAB-based approach to distort incentives, the CAA argued that it was important to ensure that the price cap profile did not unduly constrain the ability of the CAA from adopting a different regulatory approach in future. This pointed towards adopting Options B or C, rather than the flat profile implied by Option A.

The CAA's proposed price cap profile

4.20 Overall, the CAA argued that there were three particular considerations that affected the extent to which the three possible price cap profiles were best calculated to meet the CAA's statutory objectives, namely that:

- a reduction in the price cap at Stansted from current levels could have adverse impacts on investment at other airports;
- the Stansted price cap could hold prices below the long-run competitive price level and have adverse affects on other airports, particularly if the price cap profile does not allow prices to move towards the competitive price level over time; and
- the Stansted price cap could distort investment decisions at Stansted and at other airports if prices do not reflect measures of incremental cost by the time that significant capacity enhancements are being contemplated.

4.21 As a result, the CAA proposed to adopt the price cap profile implied by Option C. This option would avoid requiring a reduction in prices in the early years of Q5 whilst also ensuring that the charges can move towards the long-run average competitive price level over time, reducing any distortions to future investment decisions. The CAA also noted that, due to the proposed K-mechanism, under Option C the airport operator would, in practice, also be permitted to follow the price profile implied by Option B.

Consultation responses

AUC

4.22 The AUC referred to the current uncertainties surrounding the future rate of growth in demand at Stansted and that this created difficulties for the CAA in setting a price cap that would be suitable for the next five years. The AUC argued that the related impacts of the economic slowdown and changes in the level of competition pressures from other airports can be expected to influence investment decisions and that it was, therefore, sensible for the CAA to flag up the possibility of review of the price cap during Q5.

4.23 The AUC also argued that it is in the passenger interest for price caps to be set at levels which encourage competition between airports. The AUC noted the CAA's view that the level at which a price cap is set has a direct impact

on competition between airports which share catchment areas and argued that this was particularly true at Stansted, as the no-frills point-to-point airlines using the airport generally compete using a broader geographical range of airports than airlines operating via hub airports and are also likely to be more responsive to changes in the competitive environment because of the cost sensitive nature of the market. The AUC offered its support to the CAA undertaking a periodic assessment of the level of competition between Stansted and other airports during Q5.

BAA

- 4.24 In its written submission BAA questioned whether the CAA could contend that the price caps should not be considered to be the result of a RAB-based approach. In particular, BAA argued that the CAA appeared to have accepted the Commission's recommendation that such an approach should be the basis for the price control for Q5. BAA stated that the CAA had not put forward a convincing argument as to why the proposals were not reflective of a standard RAB-based approach.
- 4.25 At the oral hearing, BAA stated that the proposed profile of prices, with flat prices followed by an increase, was reasonable but that it had no other comments on the material presented by the CAA in chapter 5. In particular, when asked, BAA noted the CAA's statements that it is not committing to a RAB-based approach in Q6 but did not offer any acceptance of this approach, summarising its position as being relatively neutral to the 'so-called hybrid cap'.

SACC

- 4.26 In its written submission, the SACC stated that it did not agree with much of the analysis contained in chapter 5 of the CAA's proposals document but did not intend to comment in detail on this material. The SACC stated that it did intend to participate fully in the CAA's future work programme to consider how Stansted should be regulated in Q6. However, the SACC made a number of comments, in its written and oral evidence, that relate to the assessment of the consistency between the proposed price cap and the CAA's statutory objectives. These are summarised below.

Approach to assessing the price cap against the CAA's statutory duties

- 4.27 The SACC's written evidence referred to the approach of using the Commission's recommendations and also an evaluation of the impact of the proposed price caps on competition as a 'fudge and one that users will not accept'. The SACC also stated in its oral evidence that there may be elements within the price cap that are not consistent with the CAA's statutory duties.

- 4.28 When asked at the oral hearing, the SACC agreed that it was legitimate for the CAA to check whether the price cap was consistent with, does not undermine, and did not constrain the potential for competition between airports. However, the SACC stated that if the CAA regulated properly – which is to ensure that whatever goes into the RAB is efficient and economic – there would be no concern that regulation would undermine the potential for competition in the London market.

The use of LRAIC as a proxy for the competitive price level

- 4.29 The SACC stated in the oral hearings that it was a reasonable concept to check that the price cap was no lower than the competitive price level but explained that there was no agreement as to what the competitive price might be and that prices in a competitive market were very unlikely to bear any relation to long-run incremental costs and that an approach based on long-run incremental cost was not appropriate.
- 4.30 The SACC also argued in the oral hearing that the price cap would be close to the competitive price level if it were set at half the price level that currently prevails at the airport. In support of this view, the SACC referred to evidence that Ryanair had previously submitted to the CAA of the level of prices at other airports across Europe.
- 4.31 In its written evidence, the SACC argued that it was relevant that the Commission had rejected the CAA's suggested alternative approaches to regulation and had recommended that a LRAIC based approach was not appropriate for Stansted in Q5. In addition, the SACC argued that, in light of the Commission's clear rejection of a LRAIC based approach for Q5, the CAA simply had no evidence upon which to base an assessment, invalidating the use of such an approach.
- 4.32 The SACC stated that if the CAA were to adopt any cap set, even in part, on the basis of an estimate of LRAIC it would potentially breach the regulator's general duties of transparency and fairness. The SACC stated its concern that the CAA had not produced any real evidence to justify the use of a LRAIC price cap approach, beyond its own theoretical assertions, and that the CAA's arguments were not supported by the Commission or BAA.

The calculation of LRAIC estimates

- 4.33 The SACC also argued in its written evidence that it was not appropriate to use the cost estimates of BAA's current proposals for SG2 as an input into any LRAIC based estimate of the future price, even on the basis of the lower costs estimated by the Commission's consultants. As a result, the SACC argued that the value of LRAIC estimated by the CAA was highly likely to represent an inflated estimate of the incremental cost of any capacity and that the CAA's assessment was not valid and could provide no benchmark against which to assess the price profile which should apply in Q5. To

support this view, the SACC stated that it would present evidence at the SG2 Inquiry, if it proceeds, that there was at least one substantially cheaper option for the development of Stansted than the scheme put forward than BAA and that it was possible that a new owner might bring forward a substantially different and cheaper scheme.

- 4.34 The SACC stated that in using the wrong basis to make the assessment of future prices, the CAA ran a high risk of setting a price cap which was above the competitive level, with adverse consequences not just for users of Stansted but for users of other airports.

Stansted's competitive environment

- 4.35 In its written evidence, the SACC considered that CAA could not reject the Commission's analysis of the extent to which Stansted is presently subject to competitive constraints or seek to substitute its own 'discredited view', arguing that the CAA's view was rejected by the Commission, in proposing a binding building blocks based price cap for Q5, and by the Department for Transport, when it rejected the CAA's proposal that Stansted should be de-designated. The SACC also stated that it did not agree that the existence of price caps at Heathrow and Gatwick provided a constraint on price and service at Stansted.
- 4.36 When asked at the oral hearing about the potential for Stansted to affect other airports, the SACC stated that: Stansted has significant market power; unless there is a significant increase in capacity in the London market, this position will not change; and in terms of market power issues Stansted does not have any particular competitive interaction with other airports or impact upon them. When asked whether, if Stansted priced differently or invested differently it would impact upon any other airport, the SACC stated that it would not, unless it operated in a competitive market.

The impact of RAB-based regulation on incentives

- 4.37 In its written evidence, the SACC stated that the CAA had wilfully misinterpreted the SACC's position on Stansted development, that airlines at Stansted were not opposed to the airport's further development, and that it '...strongly refutes the suggestion ... [that] RAB based regulation necessarily distorts airline incentives to the extent that airlines *'can have an interest in opposing development.'*
- 4.38 The SACC also strongly rejected the CAA's argument that the distortions of RAB-based price controls reduce the reliance the CAA can place on the views of airlines and stated its surprise that the CAA would make such an assertion without any basis in evidence or theory and without any theoretical or tangible examples to back it up. The SACC argued that it was wrong for the CAA to downplay the views of a regulated monopoly's front-line customers in this way, particularly as the CAA is supposed to be protecting

the interests of airlines. The SACC stated that both airlines and airline customers have the same interest in ensuring that development is cost effective, which will lead to additional services. It also questioned how the CAA could reach this view when in all other aspects of aviation the CAA has been a strong supporter of the benefits of airline competition.

- 4.39 When asked at the oral hearing about the potential for RAB-based regulation to distort incentives, the SACC stated that this was the key failing of the RAB approach, explained that the SACC had raised this issue with the DfT and Commission and welcomed the CAA's recognition of the issue. The SACC argued that the RAB approach does not deal with significant large-scale investment very well because there are very difficult incentives placed on both sides and that if economic actors are put into a situation where they are not able to comply with competitive pressures then incentives are misaligned. However, the SACC does not agree with the way that the CAA has described the issue in the proposals document, as the SACC does not consider that it means that airline interests are not aligned with passenger interests.

Ryanair

- 4.40 In its written response, Ryanair endorsed the detailed written response submitted by the SACC and made no additional comments on this material. At the oral hearing, Ryanair argued that Stansted's pricing was an abuse of dominance, that the airport was pricing up to a 'massively inflated cap', and that the price cap should be reduced to a level reflecting the prices paid prior to the recent doubling of charges.

CAA assessment

- 4.41 The CAA's assessment is structured in six sections that consider the main themes arising from respondents: the overall approach to assessing the price cap against the CAA's statutory objectives; the use of LRAIC as a proxy for the long-run average competitive price level; the approach to estimating LRAIC; the impact of Stansted on other airports; the distorting effects of RAB-based regulation; and the potential impact of statements made by the CAA on airport and airline incentives. This is followed by a section that considers the impact of new evidence, as discussed in chapter 3, on the CAA's assessment of the appropriate price cap profile, against the CAA's statutory objectives.

Approach to assessing the price cap against the CAA's statutory duties

- 4.42 The CAA notes the statements by BAA and the SACC that question the CAA's claim that the approach adopted is, in effect, a RAB-based 'building block' price control. The SACC also questioned how the CAA's approach would affect behaviour in Q5. The CAA considers that a key feature of a RAB-based approach is that there is a clear commitment to setting future price caps to reflect actual (and planned) capital investment. In this regard,

the CAA consulted on making an unambiguous statement that there should be no presumption that the price cap will be set using the RAB-based 'building block' approach. This clear statement – repeated in the CAA's conclusions in chapter 5 – should affect the expectations held by BAA and airlines as to the likelihood that the current link between capital investment and the price caps will be retained. This statement means that BAA cannot assume that higher investment will mechanistically lead to upward pressure on the price cap set, whilst airlines cannot assume that agreeing to higher investment will mechanistically lead to an increase in the charges they will pay. Similarly, neither party can assume that lower levels of investment will mechanistically lead to a reduction in the price cap. The CAA considers that this change in expectations should have a significant effect on the incentives faced by parties.

4.43 The CAA does not agree with the SACC that it has failed to provide evidence to justify the relevance of measures of LRAIC to the assessment of the Stansted price cap. The CAA has set out a clear argument as to why measures of LRAIC are relevant to identifying a price cap profile that is consistent with its statutory objectives. This argument has a number of elements:

- The CAA's statutory objectives require it to consider the impact that the Stansted price cap will have on other airports, their users and their investment plans and profitability. The CAA explained this point in paragraphs 5.30 to 5.38 of the proposals document.
- The market position of Stansted means that the price cap could affect other UK airports. The CAA explained this point in paragraphs 5.15 to 5.29 of the proposals document, and referred to some of the relevant evidence in paragraphs 5.66 to 5.70.
- The CAA should, therefore, compare the proposed price cap to the price level that would be expected to prevail in a well-functioning airport market (i.e. to compare it against the 'competitive price level'). The CAA explained this point in paragraphs 5.63 to 5.55.
- Two relevant measures of the competitive price level are average (depreciated) replacement cost and long-run average incremental cost. The CAA explained the relevance of these measures to the competitive price level in paragraphs 5.77 to 5.88.

4.44 This approach was explored at the oral hearings with the SACC. The SACC clarified that it did not object to the CAA comparing any proposed price cap to the competitive price level. Rather, its objections related to the use of LRAIC as a proxy for the competitive price level, to the calculation of LRAIC and to the impact that Stansted has on other airports.

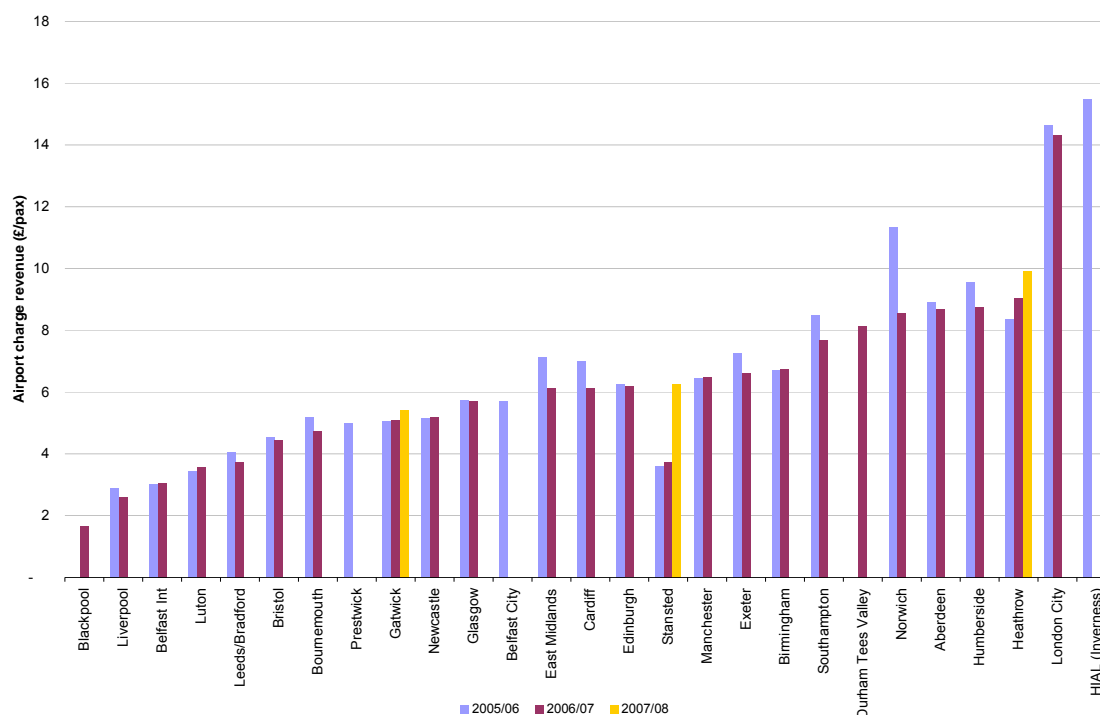
The use of LRAIC as a proxy for the competitive price level

- 4.45 In respect of the first, the CAA disagrees with the statements made by the SACC that it has failed to justify the relevance of LRAIC measures to the assessment of the competitive price level. As noted above, the CAA set out an explanation in the December 2008 proposals document. The CAA also commissioned and published in April 2008 a report by Europe Economics that explained the relevance of measures of long-run incremental cost to the assessment of the competitive price level and cited a number of examples where such cost measures had been used in other sectors.
- 4.46 It is also relevant that, whilst the Commission recommended against setting a price cap equal to an estimate of LRAIC, the Commission also recognised that there might be advantages to adopting price control approaches based on measures of current and forward-looking cost. In particular, it stated that:
- ‘... as [a LRAIC-based price cap] would remove the link between actual or planned investment and the price cap, it could help to ensure that only economic investment is undertaken. Furthermore, 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.’⁵⁶
- 4.47 Furthermore, the CAA did not propose in December 2008 to set the price cap equal to an estimate of LRAIC. Rather, the CAA argued that it was relevant to use LRAIC estimates as one indicator of the competitive price level and to place some weight on the potential divergence between the price cap and this level. The CAA did not, however, argue that this was the only possible relevant measure of the competitive price level.
- 4.48 The CAA is mindful of the risk, noted by the SACC, that the price cap could be set above the competitive level. There are a number of factors that mitigate this risk. First, the average level of the price cap reflects the recommendation made by the Commission, which was made based on a ‘building block’ calculation of historical and projected efficient costs. Second, the analysis in chapter 3 suggests that, if anything, there could be a case for setting a ‘building block’ price cap at a somewhat higher level than that recommended by the Commission (corrected for non-passenger flight revenues), reflecting the likely direction and plausible magnitude of new evidence on the individual ‘building blocks’. Third, the CAA has compared the price cap to conservative estimates of both incremental and replacement cost, which indicates that, whilst the price cap is moving towards these measures of cost, the average price cap over Q5 is somewhat below these levels and is, therefore, likely to be below the long-run average competitive price level. Furthermore, there is evidence from airport-airline negotiations and the discount schemes made available at the airport that suggests that

⁵⁶ CC October 2008, paragraph 4.8

the price cap might not, in the event, be binding, mitigating the risks associated with setting the price cap at too high a level.

- 4.49 However, the SACC challenge this view, and refer to evidence of charges at other European airports as indicating that the competitive price level is significantly below the current level of charges at Stansted which would imply that the proposed price cap for Stansted would be significantly above the competitive price level.
- 4.50 The SACC cited confidential evidence provided by Ryanair to the CAA that compared the level of airport charges that the airline pays at a number of airports across the UK and continental Europe. This evidence reported that Stansted airport was approximately 30 per cent more expensive than the next most expensive airport. The CAA sought, but was not provided with, further information about this evidence, including the underlying data, so as to understand better the basis of this comparison. In addition, the CAA compared this evidence to confidential data provided by easyJet. This alternative data revealed a similar relationship between the charges paid by easyJet and Ryanair at airports where both of the airlines operate. However, Stansted (and one other airport) did not follow this general pattern. This implied that Ryanair, but not easyJet, faced higher relative charges at Stansted. The data provided by Ryanair also revealed that it was paying substantially less to operate from Gatwick than at Stansted. As Gatwick has been setting its charges in order to recover the maximum allowed revenue under the price cap, this relationship was not consistent with other information about relative charges at the two airports. Without access to the underlying data, it was not possible for the CAA to investigate these questions further.
- 4.51 The CAA also undertook analysis of the easyJet data to consider whether it supported the view that the charges at Stansted were out of line with those levied at comparable airports. This analysis – which cannot be published as it is based on confidential information – shows that Stansted charges do not appear to be out of line with those charged by airports of a similar size and that there are a number of airports with implied charges that are somewhat higher than those at Stansted.
- 4.52 This evidence is broadly consistent with the analysis previously published by the CAA that used airport accounting data to compare the average revenue from aeronautical charges at a number of UK airports. As Figure 4-1 shows, whilst the level of charges at Stansted has increased in recent years – reflecting the expiry of a number of discount agreements – the level of aeronautical revenue at Stansted is lower than at a number of other UK airports.

Figure 4-1 Average airport charge revenue per passenger

Source: Airport accounts, adjusted for the treatment of ANS costs at BAA's airports.

- 4.53 On balance, therefore, the CAA does not consider that the available evidence on relative prices supports the view that charges at Stansted are currently above the competitive level.

The calculation of LRAIC estimates

- 4.54 In respect of the second objection – that the calculation of LRAIC was inappropriate – the CAA agrees with the SACC that it is conceivable that the estimates of the cost of expanding Stansted produced by the Commission's consultants (ASA) might be above the efficient level.
- 4.55 However, the CAA continues to believe that the estimate of LRAIC represents a conservative estimate of the likely value of long-run incremental cost. In particular, the CAA adopted a cost of capital assumption of 7.1 per cent (i.e. the level recommended by the Commission for Stansted during Q5) – an estimate of the average prevailing cost of capital for the airport, whereas an estimate of the expected value of LRAIC would normally be calculated using the cost of capital associated with the incremental project. This marginal cost of capital is likely to be higher than the average cost of capital across the existing operations, not least due to the higher risks associated with incremental development.⁵⁷
- 4.56 Against this background, the CAA continues to consider that the adoption of a 7.1 per cent cost of capital assumption, together with the ASA 'most likely' scenario for the project cost, £7 per passenger is likely to represent a

⁵⁷ The CAA also presented an illustration of the impact of adopting higher cost of capital of 8 per cent on the estimate of LRAIC, which increased the estimate of LRAIC from £7 to £7.90 per passenger.

conservative (i.e. low) estimate of the actual average incremental cost of expansion. Further, whilst there is inevitably uncertainty surrounding this estimate, this calculation provides one source of evidence of the likely level of the competitive price level and the CAA considers it appropriate to place some weight on this estimate when considering the consistency of the price cap proposal with the competitive price level.

The impact of Stansted on other airports

- 4.57 The CAA notes the SACC's view that Stansted airport has significant market power (SMP) and that, without a significant increase in capacity, this position is unlikely to change. However, the CAA does not agree with the SACC's claim that the CAA's analysis of the market position of Stansted has been 'discredited'. The CAA has set out its views on the analysis undertaken by both the Commission⁵⁸ and the DfT⁵⁹ and explained its view as to the reasons where there are differences in view.
- 4.58 Further, the SACC appears to misstate the position of the Secretary of State. As noted in the April 2008 reference to the Commission, the Secretary of State concluded that '... on balance, it is probably the case that Stansted Airport alone does not currently have substantial market power', that 'on balance, the evidence suggests that it is more likely than not that Stansted Airport alone will acquire substantial market power in the future, although this conclusion is finely balanced', and that 'the exercise of market power at Heathrow and Gatwick airports is separately addressed through the CAA setting price caps for these two airports'. It should also be noted that this decision was reached against a background of the continued ownership by BAA of Heathrow, Gatwick and Stansted, whereas it now appears likely that this ownership structure will change in the near future, with the potential for both Gatwick and Stansted to be sold.
- 4.59 Furthermore, the SACC's comments focus on the strength of the competitive constraints faced by Stansted. However, as stated in December 2008, the CAA considers that when setting the price cap for Stansted the more important issue to consider is the extent to which Stansted affects other UK airports, their users, and their investment plans and profitability. The SACC argue that there is no particular competitive interaction with other airports or impact upon them. The CAA does not consider that this view is supported by the balance of available evidence. For example, the CAA explained in December 2008 that Stansted's conduct appears to affect the pricing and investment plans at Luton Airport. In addition, in response to questioning at the oral hearings, the CAA was provided with confidential information from BAA summarising its negotiations with a number of airlines.⁶⁰ Analysis of this information by the CAA supports the view that Stansted and Luton affect

⁵⁸ CAA December 2008, paragraphs 5.16 to 5.29

⁵⁹ CAA reference to the Competition Commission, April 2008, chapter 6

⁶⁰ Due to the confidential nature of this material, it has not been reproduced in this document.

each other's pricing, which is consistent with the balance of evidence previously considered by the CAA.

The impact of RAB-based regulation on incentives

- 4.60 The CAA agrees with the SACC that RAB-based price controls can distort the incentives faced by airports to bring forward efficient capital investment, but notes the views expressed by the SACC as to the distortion of airline incentives and how the CAA can argue that airline interests are not aligned with those of passengers, when it has been a strong supporter of liberalisation in aviation.
- 4.61 The CAA considers that it is important to distinguish clearly between two related issues. The CAA considers that where competition is undistorted by regulation there is likely to be a high degree of alignment between airline and passenger interests and, by following their commercial interests, airlines (and airports) will deliver outcomes that are in the best interests of passengers. However, where competition is distorted by regulation – as is the case when RAB-based price controls are applied – the commercial interests of airports and airlines may not align with the best interests of passengers. There is no implied criticism of airlines (or airports) in this statement. Rather, the potential for a misalignment in incentives is a consequence of the presence of regulation.
- 4.62 The CAA remains of the view that RAB-based regulation may distort the incentives of both airports and airlines. Airlines are likely to be aware of the incentives faced by the airport operator – which they have demonstrated they are – and to adopt positions that reflect their commercial interests. This also explains why the presence of RAB-based regulation affects the reliance that the CAA can place on the views expressed by airlines (and the airport operator). These views will reflect the commercial interests of the airlines which, if affected by regulation, might not be aligned with the interests of passengers. This does not mean that these views are not considered and analysed carefully.
- 4.63 As such, the CAA does not believe that it has 'wilfully misinterpreted' the SACC's position on Stansted development. Indeed, the CAA did not cite the position of the SACC as evidence of the distortions that RAB-based regulation has on the incentives faced by airlines. Rather, the CAA relied upon an analysis of the underlying incentives that such a price cap has on incentives. It illustrated these incentive effects in a Supporting Paper to the proposals document.

Other issues

- 4.64 The CAA notes the SACC's argument that the CAA cannot depart from the Commission's recommendations. However, the statutory framework does not require the CAA to apply the price cap recommended by the

Commission. Instead, the framework obliges the CAA to reach its own view, having regard to the recommendations made by the Commission.

The impact of new evidence on the CAA's assessment

4.65 Chapter 3 set out the CAA's views on a range of evidence and views on the individual 'building blocks' that underpin a RAB-based calculation of a price cap. Some of this material is potentially relevant to the assessment of the how the resulting price cap profile is best calculated to meet the CAA's statutory objectives and is discussed below.

Changing inflation expectations

4.66 Chapter 3 explained that since the CAA reached its proposed price caps for Stansted there has been a reduction in inflation expectations, reflecting the deterioration in general prospects for the UK economy. As the proposed price cap for 2009/10 was couched in nominal terms the downward adjustment in expected inflation has two main effects: through the impact on the real value of the opening year price cap; and through the operation of the RPI-X adjustment. The impact of these two effects is to increase the likely real value of the price cap profile, potentially by around 2½ per cent, although this estimate is dependent upon the outturn profile of inflation which is currently subject to a significant degree of uncertainty. In contrast, the changing expectations of inflation in the near-term do not affect the real value of the measures of LRAIC and of (depreciated) replacement cost at Stansted.

4.67 A consequence of this is that the relationship between the proposed price cap and forward-looking measures of cost may have changed somewhat and, in particular, that the price cap profile is now slightly more likely than it was in December to reach the estimates of incremental cost or of replacement cost presented in the proposals document. However, the impact of the change in inflation expectations has a greater effect on the real value of the price cap in the early years of Q5. Indeed, towards the end of Q5 the change in inflation expectations is unlikely to have a significant impact on the relationship between the price cap and forward-looking measures of cost.⁶¹

4.68 To illustrate this point, in December 2008, the proposed price cap profile would result in an average price cap of £6.17 across Q5 and would reach £6.34 in 2013/14. These values compared to estimates of LRAIC of between £7 and £7.90 (2007/08 prices). Repeating this comparison taking into account the impact of changing inflation expectations results in a 2½ percentage point increase in the real value of the average Q5 price cap – which results in a comparison between an average price cap of £6.32 and an estimate of LRAIC of between £7 and £7.90. In addition, the proposed price cap for 2013/14 would increase by 1.4 per cent, to £6.43. These changes do

⁶¹ The impact of changing inflation expectations is to increase the real value of the price cap in year one and then to have the opposite effect in year two. The resulting net effect of these impacts is to leave the real level of the price cap in years 3 to 5 largely unchanged.

not appear to have a significant bearing upon the arguments presented by the CAA on how the proposal is best calculated to meet the CAA's statutory objectives.

- 4.69 Furthermore, it is worth noting that the figures for incremental and replacement cost were average figures. As the CAA set out in April 2008, prices in a well-functioning airport market would be expected to vary around the average competitive level, depending upon the supply-demand balance. As discussed in chapter 3, whilst there is some downside risk associated with the available traffic forecasts, these forecasts still indicate a return to growth in traffic by the end of Q5. Should this forecast growth occur, this would tend to put upward pressure on prices in a well-functioning market and, in light of the consequent growth in capacity constraints, would tend to increase the competitive price level above the long-run average level.

Cost of capital

- 4.70 Chapter 3 discussed the new evidence available about the average cost of capital faced by Stansted. As noted above, the cost of capital is an important input into the calculation of both replacement and incremental cost measures, albeit that the latter relies upon an appropriate estimate of the cost of capital. In principle, therefore, any upward adjustment in Stansted's average cost of capital might suggest that there was a need to increase the cost of capital used to calculate replacement and incremental cost measures.
- 4.71 As set out in chapter 3, the evidence emerging from debt markets indicates moderate upside risk to the cost of capital recommended by the Commission. However, in the context of the CAA's analysis of the relationship between the competitive price level and the price cap profile the potential scale of any adjustment does not appear material.
- 4.72 For example, in chapter 3 the CAA incorporated two cost of capital sensitivities of 7.2 and 7.4 percent in its modelling, which were derived from the discussion of the cost of debt. An increase in the cost of capital assumption of 0.2 percentage points would correspond to approximately a three percent increase in the measures of incremental cost. This change would tend to increase slightly the degree to which measures of forward-looking cost will exceed the level that the price cap reaches at the end of Q5. However, in light of the fact that the CAA used conservative estimates of forward-looking cost, this change in the relationship between the likely price cap and measures of forward-looking cost does not appear to be material.

Traffic

- 4.73 Chapter 3 set out the emerging evidence that might suggest that the downside risks associated with the traffic forecasts have increased since the CAA made its proposals. Should these risks crystallise, this could lead to a significant reduction in the ability of the airport operator to generate revenues

in line with the allowed revenue implied by a 'building block' calculation consistent with the Commission's recommendations to the CAA.

- 4.74 However, if an alternative point estimate for traffic could be established, adjusting the traffic 'building block' forecast downwards would have the effect of increasing the price cap in the periods where traffic was expected to be lower than previously forecast (i.e. in the early years of Q5). In contrast, in a well-functioning airport market, where a reduction in demand leads to lower traffic and a significant reduction in the scarcity of capacity this would be expected to put downward pressure on the short-term competitive price level. Indeed, this difference serves to highlight one of the potential perverse impacts of a strict application of a 'building block' methodology.
- 4.75 This expected downward pressure on the *short-term* competitive price level might also increase the likelihood that the price cap is above the short-term competitive price level, particularly in the early years of Q5. However, evidence emerging from airport-airline negotiations on the prices that may be charged at Stansted suggests that there is already downward pressure being exerted on prices. This reduces the risk that prices will be set at an unreasonable level.
- 4.76 However, the new information on the increased downside risk to short-term traffic forecasts would not be expected to affect the long-run average competitive price level. Calculations of incremental cost should be based on the assumption that expansion only occurs efficiently and, by implication, only when traffic forecasts are sufficiently robust to justify such expansion. As such, whilst recent evidence on actual traffic growth might affect short-term traffic forecasts and the efficient timing of expansion, it does not affect the estimation of the long-run competitive price level.
- 4.77 This potential impact on the likely date at which the second runway might become operational has a further impact on the analysis previously presented by the CAA. In December 2008, the CAA argued that it was important to ensure that the price cap profile would not unduly constrain the ability of the CAA to adopt different regulatory approaches in future, whether they be RAB-based price controls derived from historical measures of cost or other approaches that place greater reliance on forward-looking measures of cost. In practice this means that, over time, the difference between the price cap and forward-looking measures of cost should not be so great as to impact upon the credibility of the CAA choosing to implement whichever approach may be preferred in the future.
- 4.78 The CAA also noted the relevance of the likely timing of the SG2 project and that, as the Commission noted, the available passenger forecasts then available suggested that the SG2 project would not appear to be needed before 2017/18. As a result, the CAA took comfort from the fact that this meant that there was a reasonable period following the end of Q5 in which to

seek to ensure that any future price cap will not constrain prices in ways that are likely to distort major investment decisions.

- 4.79 Were the greater downside risk attached to the traffic forecasts presented by the Commission in its recommendations to materialise it could imply additional time before the construction of a second runway. This provides the CAA with some additional comfort that there is likely to be sufficient time to reduce any significant divergence between future price caps and estimates of the long-run average competitive price level and that, as a result, it is credible that the CAA could implement alternative regulatory approaches, should they be justified.

Impact of other building blocks on forward-looking measures of cost

- 4.80 Chapter 3 also considers a range of views about projected levels of operating and capital expenditure costs and the regulatory treatment of historical costs incurred. However, these elements of cost do not relate directly to the future long-run cost of airport operations and, therefore, do not appear to change the CAA's assessment of the likely average competitive price or the relationship between the proposed price cap and this level.

Assessment of the implied RAB-based price cap

- 4.81 In chapter 3 the CAA stated its view that, whilst there was considerable uncertainty attached to the estimation of a number of the underlying 'building blocks', the balance of available information following the Commission's recommendations could have the effect of putting upward pressure on the revenue allowed in Q5 calculated by a mechanistic application of the 'building block' methodology. That said, the CAA also stated that it is not clear that a regulatory authority applying a 'building block' price control would necessarily adjust the Commission's price profile to reflect this new information. Nevertheless, the new information on the individual cost, revenue and traffic 'building blocks' does suggest that the airport operator might now be subject to greater downside risks to its overall profitability in Q5 than was the case at the time of the CAA's December 2008 proposals⁶².
- 4.82 The weakening of the UK's economic prospects suggests that it is now more likely that Stansted's pricing and profitability over Q5 will be constrained by the market, rather than by the price cap. Consequently, the airport's profitability, and its ability to recover efficient costs incurred should demand be sufficiently strong, will depend more upon the CAA's future regulatory policy than on the precise level of the price cap profile within Q5. This

⁶² In December 2008, the CAA referred to the need to consider whether the proposed price cap would prevent the airport operator from setting prices that allowed it to recover sufficient revenues to meet the efficient costs it is likely to incur over Q5. It also took comfort from the analysis undertaken by the Commission, the alignment between the proposed price cap profile and the likely pattern of demand across Q5 and the ability of the airport operator to roll-forward under-recoveries through the 'K mechanism'. However, the CAA also noted that over the longer term the sufficiency of the price control revenues will depend on the broader regulatory approach adopted in future.

potential limitation on the airport operator's ability to set charges in line with the price cap suggests that any upward adjustment to the price cap profile would have a very limited impact on the airport operator's profitability during Q5.

- 4.83 Furthermore, in assessing whether a price cap achieves the objective of furthering the reasonable interests of users of UK airports, it is reasonable to consider the likely pricing that would be expected in a well-functioning airport market. In such an airport market, a reduction in demand would be expected to put downward pressure on the price level. Indeed, there is some evidence to suggest that this downward pressure is currently present at Stansted. This expected pattern of short-term pricing argues against making an upward adjustment to the price cap in the early years of Q5.
- 4.84 The CAA is, however, mindful of the high level of short-term uncertainty that is attached to current traffic forecasts, something that reflects, in part, the market position of the airport. As noted in chapter 3, the Airports Act contains a mechanism by which the price cap can be varied with the agreement of the airport operator. In practice, this means that a mechanism exists to increase, but not to reduce, the price cap.⁶³ Whilst the CAA would not expect to re-open the price cap simply to adjust for a further weakening of demand, this mechanism does provide the airport operator with a way to seek an adjustment if new evidence emerged to suggest that the price cap was significantly below the short-term competitive price level.
- 4.85 On balance, therefore, and in light of its statutory objectives, the CAA considers that the available information about the level of the average price cap implied by a RAB-based 'building block' price cap calculation does not provide a strong case for the CAA to revise its December 2008 proposal. Rather, it highlights the need to ensure that there is an appropriate long-term framework to reward efficiently incurred costs over time, whilst allowing prices to vary according to market demand in the short-term.

Summary

- 4.86 In this chapter the CAA has considered the extent to which the arguments and analysis put forward by respondents and the available new market evidence affects the assessment of the proposed price cap profile against the CAA's statutory duties.
- 4.87 It appears that the impact of new information does not significantly affect the CAA's previous assessment. The available information on the appropriate cost of capital might increase measures of forward-looking cost, but this effect is likely to be offset by the impact of additional downside risk to traffic. This additional risk, should it crystallise, would be expected to put downward pressure on the short-term competitive price level and would tend to reduce

⁶³ This asymmetry is introduced by the fact that the airport operator is unlikely to consent to a reduction in the price cap.

the speed with which the price cap might need to move toward forward-looking measures of cost.

- 4.88 Furthermore, as noted in chapter 3, whilst new information suggests that there might be additional downside risk faced by the airport operator, this reflects underlying market pressures at the airport. By contrast, a mechanistic application of a 'building block' methodology could have resulted in an upward adjustment to the price cap in the very period in which the market might be expected to put downward pressure on prices paid by airlines and passengers at Stansted. The CAA has decided, therefore, not to make the adjustment that could have been implied by the 'building block' calculation of the price cap.
- 4.89 More generally, the CAA remains of the view that it is important to compare any proposed price cap against the competitive price level, so as to ensure that competing airports – and the development of competition – are not adversely affected, and that measures of replacement and incremental cost are useful measures of this level.
- 4.90 In addition, the CAA is mindful of the adverse incentive effects that an expectation of continued RAB-based regulation might have on investment decisions and the ability of the airport operator and airlines to reach agreement on how best to develop the airport. The CAA discusses its proposed response to these effects in the next chapter.
- 4.91 Overall, therefore, the CAA considers that the assessment presented in the December 2008 proposals document remains appropriate and that, in light of the evidence available now and subject to the additional measures discussed in chapter 5, the price cap profile proposed is consistent with the CAA's statutory duties.

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5. CAA's proposed price caps

Introduction

5.1 Taking into account responses to its December 2008 proposals and new information received since December 2008, the CAA has, in the preceding chapters, assessed:

- issues of price control scope and – assuming a RAB-based approach – the design of that price control;
- the individual cost, revenue and traffic building blocks making up the Competition Commission's recommended Q5 price control; and
- whether the application of the resulting price control would be consistent with the CAA's statutory objectives, recognising the potential for those statutory objectives to be best achieved by facilitating increased competition between airports.

5.2 This chapter summarises the findings from these assessments. It then goes on to consider how best to address the risk that RAB-based regulation could distort competition between airports – bearing in mind the responses received to the December 2008 consultation – and to review and update the statements of future regulatory policy, in light of developments since December 2008.

CAA's summary of findings

Assessment of price control design

5.3 In chapter 2, the CAA considered the views and evidence submitted during the course of consultation on the CAA's proposals for the price control framework and design.

5.4 In light of the broad support for the CAA's proposals in this area, the CAA confirmed that it has set the Stansted Q5 price control on the basis of the framework and design described in chapter 2, for the reasons set out in chapter 2 of the CAA's December 2008 proposals.

Assessment of cost, revenue and traffic building blocks

5.5 In chapter 3, the CAA set out its assessment of the analysis and evidence presented by the Competition Commission in support of its Q5 price cap recommendations, which in turn informed the CAA's own December 2008 price cap proposals. In doing so, the CAA considered the views and evidence submitted during the course of this consultation, and other relevant evidence which has emerged over this period, notably with respect to the UK macro-economy.

- 5.6 The CAA concluded that the price caps set out in Table 5-1 below, as proposed in its December proposals, continued to fall within the range of price caps that could be reasonably recommended by a regulatory authority applying a 'building block' methodology against the objectives set out under section 39 of the Airports Act..

Table 5-1 CAA's proposed Stansted Q5 price control

Passenger flights:					
Proposed price cap £/passenger	2009/10	2010/11	2011/12	2012/13	2013/14
2009/10 prices	6.53	6.53	6.63	6.74	6.85
Increase in price cap: retail price inflation plus X%		RPI+0%	RPI+1.63%	RPI+1.63%	RPI+1.63%
Non-passenger flights:					
Airport charges for landing and parking to be no higher than the equivalent charges for a comparable passenger aircraft					

Assessment against statutory duties

- 5.7 In chapter 4, the CAA considered the extent to which the arguments and analysis put forward by respondents and the available new evidence affected the assessment of the proposed price cap profile against the CAA's statutory objectives.
- 5.8 The CAA stated that the impact of new information does not significantly affect its previous assessment. The available information on the appropriate cost of capital might increase measures of forward-looking cost, but this effect is likely to be offset by the impact of additional downside risk to traffic. This additional risk, should it crystallise, would be expected to put downward pressure on the short-term competitive price level and would tend to reduce the speed with which the price cap might need to move toward forward-looking measures of cost.
- 5.9 Furthermore, whilst new information suggested that there might be additional downside risk faced by the airport operator, this reflected underlying market pressures at the airport. By contrast, a mechanistic application of a 'building block' methodology could have resulted in an upward adjustment to the price cap in the very period in which the market might be expected to put downward pressure on prices paid by airlines and passengers at Stansted. The CAA decided, therefore, not to make the adjustment that could have been implied by the 'building block' calculation of the price cap.
- 5.10 Chapter 4 also concluded that the CAA remained of the view that it is important to compare any proposed price cap against the competitive price level, so as to ensure that competing airports – and the development of competition – are not adversely affected, and that measures of replacement and incremental cost are useful measures of this level.
- 5.11 It also concluded that the CAA should be mindful of the adverse incentive effects that an expectation of continued RAB-based regulation might have on

investment decisions and the ability of the airport operator and airlines to reach agreement on how best to develop the airport. These issues are considered further below.

- 5.12 Overall, therefore, the CAA considers that the assessment presented in the December 2008 proposals document remains appropriate and that – subject to addressing the risk that RAB-based regulation might distort competition – and in light of the evidence available now, the price cap profile proposed is consistent with the CAA’s statutory objectives.

Addressing the risk that RAB-based regulation distorts competition between airports

The CAA’s December 2008 proposals

- 5.13 In its December 2008 proposals, the CAA proposed three ways to address the risk of an expectation of continued RAB-based regulation distorting investment decisions and the undermining the ability of the airport operator and airlines to reach agreement on how best to develop the airport.
- 5.14 First, the CAA proposed to make clear to all stakeholders – including BAA and the airlines – that there was a dual rationale for the CAA arriving at the profile set out above; that it was 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; and that had the CAA not been able to satisfy itself on this latter point, the CAA might have had to consider adopting a price cap that would have facilitated competition between airports.
- 5.15 Second, the CAA proposed to state clearly that there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted airport, whether or not the modification occurred 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).
- 5.16 Third, the CAA intended 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 proposed that the scope of this work would 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 Costs) that could serve to inform judgements about price controls in future; and
- considering how such alternative approaches to setting price controls would best be applied in practice.

5.17 The CAA stated that it would expect these steps to address the potential for substantial adverse effects to arise.

Consultation responses

5.18 BAA made relatively little comment on the material presented in chapters 5 and 6 of the CAA's December 2008 proposals, including on the specific question as to whether the proposed statements and work programme would serve adequately to address the risk identified above. BAA stated that it was relatively neutral over what it referred to as the so-called hybrid cap. However, in various places in its written and oral evidence response to the CAA's December 2008 proposals, BAA suggested that the CAA's proposals amounted in effect to a continuation of RAB-based price control regulation, and commented that it saw no reason for the CAA to pre-judge a review of whether RAB-based price control regulation would continue to be appropriate in future.

5.19 In its written evidence, the SACC encouraged the CAA to focus on the distorted incentives that undoubtedly exist in relation to the airport's ability to bring forward investment that is out of line with its customers' wishes. It questioned whether the CAA was correct in its belief that the proposed price control approach would remove these distorted incentives, arguing that under both the CAA's proposal and a RAB-based 'building block' approach, if the scheme was not required by users and is too costly, it would lead to unnecessary upward movement in airport charges with adverse consequences to traffic growth and wider consumer interests.

5.20 As a result, there was no merit in providing a signal as to the future regulatory treatment of investment and that the CAA would be wrong to take any cognisance in setting the price cap for Q5 of what decision may be taken in 2014 and in relation to an SG2 scheme, explaining that these decisions might take a very different form post-divestiture.

5.21 The SACC also stated that the CAA had effectively pre-empted any discussion over the appropriate future regulation of Stansted by signalling now how the CAA intends to regulate the airport in Q6 and by basing its Q5 proposals, at least in part, on a 'long-run market led approach'. The SACC stated that it was unfortunate that this future work seemed to be predicated on a pre-conceived outcome and urged the CAA to take an evidence-based approach to this issue.

- 5.22 In its written response, Ryanair endorsed the detailed response submitted by the SACC but made no additional comments on this material.

The CAA's analysis

- 5.23 BAA's response does not engage squarely with the question as to the extent to which RAB-based regulation could give rise to inappropriate incentives affecting the behaviour of BAA and airlines in Q5, still less with the question as to whether the steps proposed by the CAA represented an appropriate and proportionate remedy in the circumstances. It follows that nothing in BAA's response suggests that the CAA should not make the statements proposed, or take forward the work programme.
- 5.24 The CAA notes that the SACC considers that there is no merit in providing a signal about the future regulatory treatment of investment and that circumstances could change significantly following any divestment of Gatwick and, potentially, Stansted. However, the CAA considers that the fact that there is likely to be a significant increase in the degree of competition shows the importance of ensuring that regulation does not distort investment decisions and, as a result, undermine the development of airport competition. Further, the CAA considers that Stansted will undertake its investment decisions based on its expectations of the future costs and revenues that will result. As regulation can have a significant impact upon the airport's revenues, it seems reasonable to consider that changing the expectations as to the future regulatory treatment of investment could affect future investment decisions.
- 5.25 This impact on incentives will only be significant if it is sufficiently credible. This is why the CAA has taken steps to ensure that a movement away from RAB-based regulation is credible, including by ensuring that the implied price cap profile does not prevent future price caps from being set based on forward-looking measures of cost and that work is undertaken during Q5 to address the practical issues associated with estimating these measures.
- 5.26 This combination of measures is focused on keeping open the option of moving away from a RAB-based approach. The CAA has not taken a decision now as to how best to regulate Stansted in future. As such, the CAA disagrees with the SACC's claim that it has pre-judged the outcome of its future work programme. The steps taken by the CAA are specifically designed to keep a number of options open, including – if best calculated to meet the CAA's statutory duties – the application of RAB-based approaches in future.

The CAA's March 2009 decision

- 5.27 Against this background, the CAA remains of the view that, by signalling now that there should be no presumption that a RAB-based approach would apply in future, the adverse consequences of this approach to regulation can be

mitigated. This statement is also supported by the cross-check that the CAA has performed which ensures that the Q5 proposed price cap does not undermine the credibility of adopting alternative price control approaches in future and by the CAA's future work programme, which will include further work to develop alternative regulatory approaches.

5.28 As a consequence, the CAA hereby confirms that:

- there is a dual rationale for the CAA arriving at the profile set out above; that 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; and that had the CAA not been able to satisfy itself on this latter point, the CAA might have had to consider adopting a price cap that would have facilitated competition between airports;
- there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted airport, whether or not the modification occurred 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); and
- the CAA will initiate a work programme to develop further its thinking on alternative approaches to price control regulation that facilitate – rather than distort – competition. The CAA currently expects the scope of this work to include:
 - i. periodically assessing the degree of competition between airports;
 - ii. identifying and assessing alternative approaches to price regulation, as competition intensifies;
 - iii. carrying out work on estimating forward-looking costs of airport development (including, but not necessarily limited to, Long Run Average Incremental Costs) that could serve to inform judgements about price controls in future; and
 - iv. considering how such alternative approaches to setting price controls would best be applied in practice.

The CAA expects the precise scope and content of the work programme to be the subject of a consultation that the CAA would expect to launch later this year.

5.29 The CAA, therefore, has decided that the price control on Stansted airport should be the same as it proposed in December 2008, and is imposing the price control conditions in Annex B.

Other aspects of regulatory policy

The CAA's December 2008 proposals

5.30 In its December 2008 proposals, the CAA also set out – in draft form – a statement of its then current views on future regulatory policy in the following areas:

- how regulation might be expected to adapt to changing market circumstances;
- the interaction between economic regulation under the Airports Act 1986 and the SG2 planning inquiry; and
- the potential for the framework for the economic regulation of airports to change in Q5.

Consultation responses

5.31 There was very little comment on the CAA's statement of views, except that which has otherwise been taken into account above.

CAA analysis

5.32 While the CAA's proposed statements on future regulatory policy did not attract comment from interested parties, there have been several market developments in these areas since December 2008. These developments serve to underline the uncertainty faced by airports – and airlines – in current market conditions, and the potential for market circumstances to change.

5.33 In particular, the CAA notes:

- in the period since the CAA published its December 2008 proposals, BAA has continued to take forward the sale of Gatwick airport;
- on 17 December 2008, the Competition Commission published its Provisional Decision on Remedies on BAA's market investigation⁶⁴. Among other things, this set out the Commission's provisional decision to require BAA to divest Stansted, as well as a number of recommendations to Government on how the regulatory regime should be amended;
- on 2 March 2009, the Secretary of State for Communities and Local

⁶⁴ BAA Airports Market Investigation – Provisional decision on remedies, Competition Commission, 17 December 2008.

Government announced that she had decided to delay her formal announcement of the inquiry timetable for a short time so as to avoid being seen to second-guess the contents of the final Competition Commission report, nor the response of the airport operator to it⁶⁵; and

- on 9 March 2009, the Government published its proposals for reforming the framework for the economic regulation of UK airports⁶⁶. In doing so, the Government stated⁶⁷ that: 'For the avoidance of doubt, the consultation document does not propose that the introduction of the new licence-based regime for economic regulation in the airports sector would terminate, revoke, suspend or modify the existing permissions to levy airport charges at Heathrow and Gatwick airports or the basis on which the current price caps at Heathrow and Gatwick airports are set, including the price cap which will be applicable at Stansted airport with effect from 1 April 2009'.

5.34 The majority of these developments do not serve to alter the nature of the CAA's future regulatory policy statements, although the deferral of the Stansted G2 public inquiry serves to condition the relevance of the CAA's position on the interaction between economic regulation under the Airports Act 1986 and the SG2 planning inquiry because it raises the possibility that the planning inquiry may be further delayed, depending on the Competition Commission's final report, and BAA's reaction to it.

The CAA's March 2009 decision

5.35 Against this background, the CAA proposes to retain its proposed statement on future regulatory policy - largely unchanged - from those it consulted upon in December 2008. These statements are reproduced below.

Changing market circumstances

5.36 Market circumstances are changing rapidly. In September 2008, BAA initiated the possible sale of Gatwick airport. In October 2008, the Secretary of State decided to grant consent to lifting planning limits at Stansted to enable full utilisation of the first runway. And market circumstances may change again if the Competition Commission implements its proposal to require BAA to divest Stansted airport. Such changes can be expected to bear on the degree of competition affecting airports.

5.37 Market circumstances will also change by virtue, and as a consequence, of the global economic slowdown, with changing trends and volatility in oil prices and with future changes in the way that aviation is required to respond to the effects of air travel on the environment.

⁶⁵ Letter from Hazel Blears, Secretary of State for Communities and Local Government, 2 March 2009 available at www.planning-inspectorate.gov.uk.

⁶⁶ Reforming the framework for the economic regulation of UK airports, DfT, 9 March 2009.

⁶⁷ Letter to the financial sector in connection with airport regulation review, DfT, 9 March 2009

- 5.38 Where market circumstances affect the degree of competition faced by an airport, regulation should adapt. This way economic regulation can continue to be proportionate – a key principle of better regulation, and one which was recently endorsed by the Secretary of State.⁶⁸
- 5.39 The Airports Act 1986 gives the CAA relatively limited discretion to adapt regulation to reflect changing market conditions. For example, it is required to set five year price controls at those airports designated by the Secretary of State. However, even within this relatively inflexible statutory regime, there is scope for airports to be de-designated⁶⁹ by the Secretary of State or for the CAA, with the agreement of the airport operator, to modify price controls within the five-year period. If market circumstances change, it may be that the CAA (either as adviser to the Secretary of State or independently) will need to review the price controls on Stansted airport within the next five years. Ensuring that any such reviews are properly evidenced, and that such evidence is rigorously analysed and appropriate judgements made, will be a key challenge for the CAA in the next few years.
- 5.40 To ensure the CAA is well informed either in the context of re-opening the price control, resetting a price control in Q6 or in advising Government on de-designation, the CAA intends to keep competition between airports under review. This means periodically assessing the degree of competition between airports (in accordance with the work programme set out in paragraph 5.28 above).

Interaction between economic regulation under the Airports Act 1986 and the SG2 planning inquiry

- 5.41 Assuming that the Stansted G2 planning inquiry proceeds, the Inspector, the Secretary of State and/or parties involved in the SG2 planning inquiry may wish to draw on some of the evidence and/or analysis collected as part of the Stansted price control review. Anticipating this possibility, the CAA submitted an Outline Statement of Case to the inquiry which referred to the Economic Regulation Group of the CAA and its functions as the economic regulator of UK airports under the Airports Act 1986. It also submitted a Statement of Case on 22 December 2008.
- 5.42 The CAA is aware of the need for clarity as to its role, and the role of the planning inquiry. The CAA therefore sets out in the next few paragraphs its understanding of the respective roles of the Inspector and the Secretary of State on the one hand, and the CAA's role as economic regulator under the Airports Act 1986 on the other.

⁶⁸ See the Secretary of State's speech to the Airport Operators Association Conference and Exhibition 2008, November 2008, available from the Department for Transport's website: www.dft.gov.uk.

⁶⁹ Under the Airports Act 1986, it is open to the Secretary of State to designate (or de-designate) airports. Designated airports are subject to price control regulation by the CAA, de-designated airports are not.

- 5.43 The CAA understands that the Inspector and Secretary of State will weigh up the advantages and disadvantages associated with the proposals, applying the Town and Country Planning Act 1990, the Planning and Compulsory Purchase Act 2004 and other relevant legislation and authorities, before making a recommendation and reaching a decision respectively.
- 5.44 By contrast, the CAA has not carried out an evaluation of BAA's second runway proposals as part of this price control review. The CAA sets maximum limits on airport charges at Stansted and applies proportionate remedies to the Competition Commission's findings in relation to the public interest. Nothing in the Airports Act 1986 requires the CAA to take a view on the need for a second runway at Stansted, still less the wider economic, social and environmental costs and benefits that might be associated with it.
- 5.45 The CAA has, in line with the recommendations of the Competition Commission, drawn up its proposals for the Stansted Q5 price cap without evaluating the strength of the case for a second runway. Moreover, on the basis that there should be no presumption that a RAB-based approach would be used in any future modification of price controls at Stansted airport – the CAA may not, in future, need to make such an assessment. The alternative approach would be for the CAA to set price controls by reference to generic measures of the forward-looking costs of supplying airport capacity.
- 5.46 It is nevertheless conceivable that – in certain circumstances – it could be appropriate for the CAA to assess the merits of one or more specific investments, such as SG2 phase I (or SG2 as a whole). For example, this might occur if Stansted airport remained designated by the DfT for price control purposes, and if the CAA – having explored alternative safeguard caps – ultimately decided that it would be appropriate to adopt a RAB-based price control in Q6 (or at a mid-quinquennial review).
- 5.47 But even in these circumstances, the test that the CAA would expect to apply in order to decide whether (or how much) investment should be included in a projection of the Stansted RAB would be one that reflected its statutory objectives under section 39 of the Airports Act 1986⁷⁰. Such a test would – in the CAA's view – be likely to involve a comparison of the incremental benefits versus the incremental costs of investment, with the objective of replicating the decision-making test that a commercial airport operating in a competitive market might be expected to apply. Although precisely how this test would be structured and applied would depend on the circumstances, such a test is different in kind from the Government's economic evaluations (used to underpin the policies contained in the Air Transport White Paper) which considered not only the costs to the airport operator, but also the wider environmental and economic externalities (which may be positive or negative) or tests based on the extent to which a runway is currently utilised.

⁷⁰ These may, of course, be changed in future, as a result of the Government's current review of economic regulation of UK airports and any subsequent legislation from that review.

- 5.48 In practice, given that the evaluation of the business case for a second runway – in the light of the Commission’s advice – has not proved to be necessary as part of setting the Q5 Stansted price control, the CAA cannot currently foresee any circumstances where it would assess the commercial case for a second runway in advance of the outcome of the planning inquiry. Indeed, the results of the inquiry, with any resulting constraints or conditions, may itself affect the business case.
- 5.49 It is also important to understand that – regardless of the approach taken by the CAA to setting price controls – the CAA’s analysis inevitably focuses on identifiable (or internal) costs and benefits. As a consequence, the CAA does not consider wider (or external) economic, social or environmental costs⁷¹ and benefits. This wider analysis – carried out to inform the assessment of proposed development at the planning application stage – properly falls to the Secretary of State or his appointed Inspectors.
- 5.50 In summary, while the CAA intends to co-operate fully with the planning inquiry, the CAA has not needed, at this stage, to carry out for the purposes of the price control an evaluation of the strength of the case for, or against, the development of a second runway at Stansted. Nor is it part of the CAA’s role, under the Airports Act 1986, to review or comment on the wider economic appraisals conducted by the Government or by parties to the planning inquiry.

Potential for changes to the regulatory environment in Q5

- 5.51 Change to the regulatory regime applying to Stansted in future may emerge from two sources:
- DfT’s review of the framework for the economic regulation of airports; and
 - the Competition Commission’s market investigation into BAA’s airports.
- 5.52 The DfT launched its review of the economic regulation of airports in April 2008. The review was launched with three objectives: (a) improving the passenger experience; (b) encouraging appropriate and timely investment in additional capacity to help deliver economic growth in line with wider Government policy; and (c) addressing the wider environmental impacts of aviation on airport development.
- 5.53 On 18 November 2008, the Secretary of State gave a flavour of the DfT’s emerging conclusions in a speech delivered to the Airport Operators

⁷¹ The capital expenditure costs falling to the airport operator to mitigate the environmental impact of airport operation and development have been considered by the Commission and the CAA as part of the Q5 price control review.

Association⁷². In this speech, the Secretary of State articulated the Government's ambition to put passengers first, and that he anticipated switching to a new licensing regime – at least for some airports – allowing more flexible regulation. More significantly, as noted above, the DfT has now published substantive proposals for the reform of the framework for the economic regulation of UK airports.⁷³

- 5.54 For its part, the Competition Commission published its provisional decision on remedies in December 2008, and is set to publish its decision in March 2009. At this stage, it remains unclear what the Commission will conclude in relation to economic regulation, although it seems likely that its conclusions will take the form of recommendations to the Government, which could be taken forward as part of the DfT's review of economic regulation of airports. The Commission also retains the power to impose orders (or to seek undertakings in lieu of orders) under the Enterprise Act 2002.

⁷² See the Secretary of State's speech to the Airport Operators Association Conference and Exhibition 2008, November 2008, available from the Department for Transport's website: www.dft.gov.uk.

⁷³ These proposals were published so recently, i.e. a day before this decision on the Stansted Q5 price control, that there was insufficient time for them to be summarised in this document.

6. Public interest conditions: consultation

Introduction

- 6.1 In this chapter, the CAA sets out its decision on the public interest conditions regarding the facilitation of consultation at Stansted Airport. The chapter starts by providing context and outlining the initial proposals made by the CAA in December 2008. These proposals sought to remedy the Competition Commission's recent public interest finding in respect of actions by the airport relating to consultation since the last Commission inquiry.
- 6.2 In the second half of this chapter, responses to these proposals as part of the formal consultation process are summarised and evaluated. Based on this analysis, the chapter concludes with the final decision of the CAA on the public interest condition on facilitation of consultation at Stansted airport for Q5.

Context

- 6.3 Since December 2008 the CAA has held discussions with a sample of airports and airlines, other airport users and consultants in the industry. The focus of discussion has been airport / airline consultations in the UK. The intent of the discussions is to build a more detailed understanding of the issues and pressures that influence negotiations between the parties in order to inform both the public interest condition at Stansted Airport and future work related to the European Union Directive on Airport Charging.
- 6.4 Further, the CAA makes the reasonable assumption that regardless of the specific context, airports and airlines need to develop close working relationships to ensure the ongoing efficient and effective operation of their respective businesses. In addition, although airport owners have ultimate responsibility for developing airport infrastructure, it is in their interests effectively to consult airport users to ensure their plans for future airport developments meet users' needs, for example to ensure capital expenditure can be remunerated from passenger flows.
- 6.5 The discussions confirmed that a degree of tension in negotiations over future development is to be expected and that it is not uncommon for there to be unresolved disagreements between the parties. While this might in certain circumstances be the result of ineffective consultation, there might also be underlying business and commercial differences, which could not be resolved through consultation. In the context of Stansted and the Commission's Public Interest finding the CAA's decision on conditions is focussed on ensuring the processes, behaviours and information requirements for effective consultation are met.

CAA's December 2008 proposals

6.6 The CAA proposal focused on two key areas: the provision of information and the process of consultation.

Information

6.7 On the provision of information, the CAA proposed a condition that would require Stansted Airport Limited (STAL) to conform to the principles set out by the Commission in its report⁷⁴. This would give the CAA the power to define (in a statement separate from the condition itself) the scope and degree of detail around the information required. It would also enable the CAA to secure future changes to these arrangements, following consultation with the airport and airlines on proposed changes, which may be warranted within Q5.

6.8 The CAA considered the Commission's detailed specification⁷⁵ of the information which it recommended BAA should provide to its airline users under the terms of this condition. In broad terms, the CAA agreed with the suggested specification, subject to the following comments and proposed qualifications:

- the CAA considered that the protocol established at Heathrow and Gatwick for airport-airline consultation on the development of each airport during Q5 (the so called Annex G agreement) did provide a good basis for a more binding protocol on Stansted's consultation performance during Q5. In the CAA's view, the Annex G agreement appeared to be being implemented in good faith by BAA at Heathrow and Gatwick, and contributed to more effective consultation processes to date in Q5 than in much of Q4;
- the CAA considered the annual Capital Investment Plan document (not the airport operator's corporate business plan) would be the appropriate main vehicle for disseminating the information to be provided, complemented where need be by exchange of information and views in response to the CIP. The scope and depth of the CIP would therefore need to be broadened somewhat from its current state;
- the CAA considered that, in the first instance, the CIP document and other information published by BAA pursuant to its obligations under the proposed condition would, by definition, be BAA's plans and would therefore embody BAA's own interpretation of the requirements of the information protocol. Thereafter, there would be the prospect of the plan garnering support from airline users via consultation. To the extent that airlines considered that BAA's provision of information fell

⁷⁴ CC October 2008, paragraph 13.19

⁷⁵ *ibid*, Appendix M

short of that envisaged in the protocol, they could seek to close the gap through direct negotiations with BAA or via the proposed facilitator (discussed below);

- the CAA recognised that there may be certain projects and other aspects within the airport development plan where BAA may not be able to provide certain information, at certain times, as a result of confidentiality issues which could include the commercial confidentiality of the airport, one or more of its current or prospective airline users, and/or issues relating to a public inquiry or legal challenge. Nevertheless, BAA should endeavour where practicable to make arrangements to disclose information requested by airline users in a manner that preserves commercial confidentiality. The proposed facilitator would also have a role in determining what is fair and reasonable to share between the parties;
- in that regard, the CAA considered that BAA could be encouraged but not required to set out the implications of proposed airport developments on airlines' overall operating costs, as to do so may require access to airlines' own detailed business and operating plans, which are not generally made available to the airport operator. BAA should, however, set out the impact for airlines in terms of prospective airport charges of major investment projects which the airport operator proposed to bring forward;
- the CAA considered that the depth and detail of information provided by BAA to its airline users should reflect the scale, significance and maturity of the project in question. BAA and its airlines should seek to agree definitions of project stages, materiality thresholds, and the accompanying specification of information provision for each category of project. If agreement could not be reached, parties could refer their differences to the facilitator.

Facilitation of Consultation

- 6.9 On the process of consultation, the CAA recognised that an independent third party can, in certain circumstances, help make a consultation process more effective, through facilitating the orderly exchange of information, thereby building trust between the parties, and where need be mediating between the parties on disputed issues. The CAA welcomed the role that the Commission played in this respect during the course of the Commission's price control inquiry, which helped to facilitate some agreement on a small core baseline programme of capital expenditure planned for Q5 (though not on the broader SG1 programme nor, more significantly, on SG2).
- 6.10 The CAA noted that the Commission recommended that a facilitator be appointed (either being the CAA or an external person or persons appointed by the CAA). The CAA considered that there would be strong advantages to

such a facilitator being fully independent of all parties involved in Stansted airport development and regulation (i.e. BAA, the SACC, the CAA), as set out below:

- an independent facilitator, rather than the CAA, would avoid the perception (by either party) that the CAA, as facilitator, may seek to steer consultation to favour one party over the other in order to defend or promote a particular regulatory policy stance;
- an independent facilitator could bring specialist expertise (in areas such as consultation and mediation techniques) to bear on the task to a greater extent than the CAA could itself; and
- were the CAA to take the facilitator role, there would be a material risk that the exercise of this role could prejudice (or be perceived to do so) its formal statutory functions in respect of the economic regulation of Stansted. The more active (and thus potentially the more effective) the CAA might be in such a facilitation role, the greater the scope for conflict with its fundamental regulatory task.

6.11 As to the selection, appointment and funding of an independent facilitator, the CAA considered that there would be benefits to the conduct of future consultation were it possible for the airport and airlines to reach agreement on a joint appointment. This could strengthen the confidence of both parties in the credibility of the facilitator's competence and independence, and encourage both parties to work constructively with the facilitator whom they had jointly selected. The CAA recognised, though, that given recent history of dialogue between airport operator and airlines on airport development, the CAA could contribute in the near term to building confidence in future consultation processes by appointing and funding the facilitator itself⁷⁶. Before doing so, the CAA would consult the parties, and would remain open to proposals from the parties for joint endorsement of a facilitator, prior to formal CAA appointment. The CAA would intend to review the operation of the facilitator after the first two full years of operation in Q5, and would at that time explore the scope for transferring the appointment from the CAA to the parties.

Consultation responses

6.12 There is broad agreement between STAL and the SACC on the December proposals and for taking forward facilitated consultation at Stansted Airport in the next quinquennium.

⁷⁶ The CAA would recover the costs of the facilitator through a special agreement with STAL under s 11(6) of the Civil Aviation Act 1982. In line with the feedback from the parties the CAA believes this will provide clear visibility to all parties of the costs of the facilitator and not give STAL any greater influence over the nature of the facilitation contract than users.

Stansted Airport Limited

6.13 STAL made a number of comments on the Commission's recommendations and in its formal response to the CAA consultation. These comments are summarised below.

- STAL was concerned about the introduction of consultation requirements under the CAA's economic regulation of Stansted that might conflict with the planning process for G2, both in terms of confidentiality and timescales. However, during the consultation STAL reiterated it saw no problem in consulting closely with airlines on future capital expenditure at Stansted;
- STAL supported in principle the introduction of a third party facilitator and mediator, to assist the airport operator and airlines conduct effective consultation. It did not, though, support the introduction of an arbitrator into the process, unless this was the CAA making binding decisions during a quinquennium. STAL considered that the parties should be allowed to disagree and that STAL should be able to make its own decisions on matters relating to its business;
- STAL considered that there should be greater recognition of the different types of project that need to be consulted on avoiding a 'one size fits all' approach;
- STAL suggested that the 'devil was in the detail when it came to information sharing and there needed to be greater precision in the types and detail of information exchanged with airlines. STAL, particularly sought greater clarification from the CAA on what should be included in a 'strategic business plan';
- STAL also suggested that there should be some recognition that effective consultation would require a two-way exchange of information and views. Some of the Commission's proposed obligations on STAL (for example, that it demonstrates the impact of projects on airline operating costs) could only be met if the airlines were willing to share necessary input information with STAL; and
- STAL suggested clarification on the time horizon that the information provided should cover: projects at different stages of maturity necessarily have differing degrees of information on which the airlines could be consulted.

During the oral hearings the CAA invited STAL to provide greater detail on the types of information that might be reasonably shared as part of a consultation process. Although STAL provided some comment and basic supplementary material it has not provided a detailed response on this issue.

SACC

6.14 The SACC made a number of comments in its response to the CAA consultation. These comments are summarised below:⁷⁷

- while the SACC welcomed the Commission's recommendations in respect of consultation in Q5, it considered that the proposed consultation remedy failed adequately to address the failure of consultation in Q4. The SACC considered that a critical issue is the absence of a business plan to demonstrate that the planned capex is economically justified;
- the SACC welcomed the CAA's proposal as a material enhancement to the current Annex G provisions at Heathrow and Gatwick.
- it did not consider that the CAA's discretion to determine the adequacy or otherwise of the information provided by STAL would be adequate to protect users' interests;
- it suggested that the public interest condition itself should set out specifically the information which STAL was required to disclose, with a clause in the condition providing for changes if circumstances alter;
- in response to questioning at the oral hearing and in supplementary submissions the SACC provided detailed views on the types of information it considered should reasonably be shared as part of a consultation process. These included:
 - the principal drivers behind the airport's central business plans;
 - the forecast demand for airport outputs for the duration of the plan;
 - the capacity the airport intends to provide to meet this demand;
 - options for development of the airport around the central plan;
 - the resourcing implications behind the developmental plan;
 - cost estimates and expected outcomes of individual projects within the capital expenditure programme; and
- finally, it considered it essential that consultation begin at a stage when a potential need for a project is identified, before solutions are considered.

⁷⁷ This includes the SACC written advice to the CAA in December 2008, their response to the consultation on the CAA's December 2008 proposals and supplementary evidence provided to the CAA after the oral hearing.

- 6.15 With regard to the recommended third party consultation facilitator, the SACC considered that responsibility for appointing such a person should rest with the CAA in order to ensure neutrality. Any appointment by STAL, even with the agreement of airlines, could risk bias in the subsequent actions of the facilitator. The SACC also considered that the facilitator should be given powers (for example, by way of recommendations to the CAA or the Commission) to compel compliance by STAL with any public interest condition during Q5.

CAA assessment

- 6.16 The CAA welcomes the broad agreement to its proposals of December 2008. In addition, the CAA believes there are a number of useful enhancements and clarifications to be made to the December proposal based on feedback to the consultation. Further, the CAA believes the information exchange requirements, and the specific guidance in Annex D as are consistent with, and give effect to, the recommendations made by the Commission in October 2008.⁷⁸

Information

- 6.17 The CAA welcomes the recent return to constructive dialogue between STAL and the SACC on a range of issues. However, without apportioning fault to either of the parties, the CAA supports the Commission's view that past consultation associated with major capital expenditure has been inadequate and some of the current tensions around consultation relate to differing interpretations of what is reasonable and unreasonable information to exchange.
- 6.18 To remedy the situation the CAA requires Stansted Airport Limited (STAL) to conform to an information protocol (Annex D). Against the background of the Commission's report; previous public interest conditions on consultation at other airports; feedback from the parties; and discussions around consultation processes at other airports the CAA believes there is a strong case for greater specificity on information exchange requirements between STAL and the SACC.
- 6.19 The CAA notes there are two levels of information required: an overall Strategic Business Plan and a detailed list of the information that should be provided on individual projects. This information must link back to a robust business case justifying future capital expenditure.
- 6.20 The Strategic Business Plan is the document that outlines STAL's vision, strategic goals and the operational results that STAL wants to achieve for its customers and users. The Strategic Business Plan forms the foundation for long-term and day-to-day operations as well as capital expenditure decisions.

⁷⁸ CC October 2008, paragraph 13.18–13.20 and Appendix M

The Strategic Business Plan need not include specific commercial information such as board papers and internal operational plans that need to remain confidential. However, the CAA notes that there are currently documents used by airports and airlines that can usefully be drawn on to support the development of a Strategic Business Plan. These include:

- the land use plan;
- the master development plan; and
- the capital investment plan (CIP).

6.21 In order to comply with the information exchange protocol (Annex D) the CAA notes that while the CIP has been a useful guide to the type of information that should be provided to airport users there is a range of additional information that is not included in the CIP such as the land use plan and master development plan that should also be provided by the airport. This additional information could be provided through an augmented CIP or in a in a separate document to be determined by the parties.

6.22 The following is therefore an outline of what the CAA considers to be a reasonable and appropriate in information exchanges between STAL and airport users. The more detailed information exchange requirements that must be complied with are set out in Annex D.

Strategic Business Plan

6.23 The CAA considers that the Strategic Business Plan should contain the following information:

- The principal drivers behind the airports' Strategic Business Plan: this includes any assumptions made by the airport regarding the future operating environment including desired levels of service and future constraints as well as the benefits to both users and the airport operator of future capital expenditure. It is not sufficient only to provide top line forecast data. It must include more specific information around airport operations and capacities.
- The forecast demand for airport outputs for the duration of the Strategic Business Plan: this includes the level of demand for airport capacity and services as well as the factors that are likely to drive demand. Further, it should include detail to allow users to identify both the demand for particular facilities or services at the airport and information to demonstrate where capacity shortfalls might arise.
- The capacity the airport intends to provide to meet demand: this includes the facilities the airport intends to supply and how these will meet forecast demand including a comparison of capacity and demand by facility. The airport should also identify how different levels

of demand will impact on service quality.

- Options for development within the Strategic Business Plan: this includes details of cost, output trade-offs and where possible the impact on user charges, service quality and capacity associated with each option. It is not sufficient only to provide top line data. It must include more specific information.
- The resourcing implications behind the Strategic Business Plan: this includes estimated total costs of the plan and pricing implications for users.

Project Information

6.24 The CAA considers that project information, provided within or under the aegis of the Strategic Business Plan, should cover:

- Cost estimates of individual projects within the capital expenditure programme: this includes information on total capital expenditure and related operating costs. This information should not be presented as a single budgeted amount. It should include information to demonstrate a breakdown of costs within the project. It should also provide information to demonstrate the benefits the project will bring to users.
- The outputs that are expected from individual projects: outputs need to be articulated in a meaningful way that allows airport users to understand the impact on their operations. Reasonable output measures would include increases in passenger or aircraft movements or measurable increases in service quality.
- The timing of projects and project performance: In order to assist users' understanding, information on the timing of projects should be provided. Further information on project performance such as out-turn performance of projects against the outputs anticipated in previous plans should also be provided.
- Project Changes: STAL needs to provide adequate transparency on project changes. This information should include the rationale for any material changes, which should be discussed with airlines before decisions are taken and the implications of any (material) change, including on benefits, costs and operational activities.

6.25 The CAA also supports the feedback of both parties that information sharing should not conform to a one size fits all approach. An independent facilitator can usefully assist the parties in defining information that is proportionate to the circumstances.

6.26 Finally, the CAA acknowledges that although the focus of information exchange requirements is on the information STAL provides to airport users

it is equally important that airlines provide relevant information to STAL. The CAA believes airlines must also contribute to their part in the consultation process and must respond within the timeframes agreed with the facilitator as well as committing their own resources to engage with STAL. If airlines are unable to meet these requirements it is not acceptable for this to be an argument for stalling capital expenditure unnecessarily.

Facilitation of Consultation

- 6.27 The CAA supports the principle that airlines need to be given sufficient time to digest information which is provided to them by STAL. The CAA believes the independently facilitated process proposed in December, the role of the facilitator specified in Annex D and the compliance mechanisms set out below will meet the recommendations made by the Commission in October 2008.⁷⁹
- 6.28 Based on the approach articulated in the consultation documents and the positive feedback from both STAL and the SACC the CAA will proceed with a commercially sourced independent facilitator. The CAA will allow both STAL and airlines to have input into the selection process as well as the right of veto over any candidate but the responsibility for the appointment resides with the CAA.
- 6.29 The aim of the facilitated consultation will be to bring the parties together to understand common objectives and to assist them to plan to achieve them without the facilitator taking a particular position in the discussion. The facilitator may mediate in areas where there is ongoing disagreement between the parties. The facilitator will have no arbitration power to impose a binding decision on the parties.
- 6.30 The role of the facilitator will therefore be:
- to develop an agreed process between the parties, including timeframes, and then to monitor compliance;
 - to provide an independent ‘reality check’ on information exchange requirements and to monitor what is reasonable and unreasonable, as well as monitoring compliance with the information protocol; and
 - to provide a periodic independent assessment of the process to both parties and the CAA.
- 6.31 Further information on the role of the facilitator is included in Annex D.

⁷⁹ CC October 2008, paragraph 13.21–13.24 and Appendix M

The role of the CAA

- 6.32 In addition to appointing the facilitator, the CAA will receive from the facilitator a quarterly report on the progress of consultation at Stansted Airport and, within that, STAL's performance against the public interest condition and the requirements of the information protocol (Annex D). The report will be available to both STAL and the SACC. In addition to quarterly reports, the facilitator will also be expected to report when they feel it is appropriate, especially in the event of an unresolved disagreement.
- 6.33 In situations where there is ongoing disagreement between the parties the CAA expects the consultation facilitator to provide a report, available to the CAA and both parties describing the consultation process, the issues of disagreement and proposals for taking forward future consultation. Given that disagreement between the parties is not in itself evidence of a problem as opposed to differing views, it is unlikely the CAA would consider regulatory action unless evidence from the facilitated process indicated STAL or the airlines had not:
- reasonably adhered to the minimum requirements of the information protocol; and
 - co-operated, to a reasonable extent, with any independent facilitator appointed by the CAA.
- 6.34 In such situations the CAA may consider regulatory action which could take a number of forms, including:
- a change to a more appropriate remedy where the CAA could review and if need be modify the terms of the public interest condition itself or the information protocol (Annex D) during Q5;
 - continuing to highlight that the CAA will incorporate relevant evidence on consultation into the development of the appropriate regulatory regime in Q6;
 - issuing a notice under section 73 of the Airports Act requiring the provision of information to the CAA; and / or
 - after investigating a complaint, the imposition of a compliance order on STAL under section 48 of the Airports Act.
- 6.35 With regard to funding of the facilitation process, the CAA will appoint the facilitator and pay for their services and then recover the costs directly from STAL under an agreement under s11(6) of the Civil Aviation Act 1982. In line with the feedback from the parties the CAA believes this will provide clear visibility to all parties of the costs of the facilitator and not give STAL any greater influence over the nature of the facilitation contract than users.

CAA decision

6.36 The CAA is imposing the condition as to the arrangements for consultation in Annex C.

7. Public interest conditions: service quality

Introduction

7.1 In this chapter, the CAA considers the views and evidence submitted during the course of consultation on the CAA's proposals for the regulation of airport service quality, designed to address the Commission's public interest finding in this area. In light of these, the CAA sets out its decisions on service quality regulation at Stansted. These decisions are implemented by a new public interest condition, set out in Annex C to this decision document, and by the CAA's Statement on Service Quality Standards and Rebates, set out in Annex E.

The Commission's public interest finding

7.2 The Commission considered the effects of BAA's failure with regard to service quality, in particular of security queue management, and found that there were adverse effects on the operational activities of the airport, which affected directly both the reasonable interests of users and the operational effectiveness of the airport. It believed these effects could be remedied through the imposition on STAL of a requirement to meet specified service standards.

7.3 The Commission recommended that a Service Quality Rebate (SQR) scheme, which established queue standards, should be imposed at Stansted, backed by penalties in the event that the standards were not met. In terms of the standards to be set for security queuing, the Commission concluded that the current operational standard (95 per cent of passengers queuing for less than 10 minutes) was both reasonable and practical: until recently this standard existed at both Heathrow and Gatwick, and, recently, Stansted had been achieving this target consistently. It was not convinced that the benefits of requiring a shorter queue standard would be significant. It also concluded that it should set an effective maximum queue length, given the evidence that, when the 10-minute target was missed, it could be missed by a considerable margin. The Commission concluded that a target which required 98 per cent of passengers to queue for less than 15 minutes would be appropriate at Stansted.

7.4 Given that the measurement and reporting of queue lengths had caused significant disagreement over recent years, the Commission concluded that an automated solution should be found to the problem identified whereby passenger queues extend beyond the entrance to the security area, and are thus not measured by the existing CCTV-based automatic measurement system. For similar reasons, it concluded that it would be desirable to put in place a degree of independent oversight of the queue measuring and reporting process; it recommended that a periodic independent audit of the process should be instituted under the supervision of the CAA.

- 7.5 The Commission noted that, although BAA objected to its public interest finding, it was willing to introduce an SQR scheme at Stansted, on the grounds that such arrangements were likely to be beneficial to service quality and would focus management's attentions on key areas of service. The Commission recommended that a condition be imposed on BAA requiring an SQR scheme to be introduced at Stansted. It believed that, if a scheme were designed in line with its recommendations, and if appropriate financial penalties were put in place to encourage compliance, an SQR scheme at Stansted should have a similarly beneficial effect to the schemes in place at Heathrow and Gatwick.
- 7.6 The Commission's proposed SQR scheme for Stansted, like that in place at Heathrow and Gatwick, included standards based on Quality of Service Monitor (QSM) scores, a survey measure of passenger perceptions. The Commission believed that the QSM offered a useful perspective on passengers' rating of service quality and, where objective measures were available, they generally agreed with QSM ratings. Further, the QSM data enabled the regulator to avoid becoming overly dependent on the airlines' views of appropriate levels of service quality, which may not always be aligned with those of passengers.
- 7.7 The Commission concluded that a similar proportion of revenue from airport charges at Stansted (somewhere between 5 and 10 per cent) should be put at risk under the Stansted SQR scheme as that which the Commission had recommended in its 2007 report on economic regulation of Heathrow and Gatwick.
- 7.8 The Commission concluded that provision for bonuses in the event that the airport outperformed its targets would not be suitable at Stansted. However, it did recommend that the incentive schemes for individual BAA executives at Stansted should be aligned with the Stansted SQR scheme, such that excellent performance on service delivery would be recognised financially.

CAA's December 2008 proposals

- 7.9 The CAA put forward for consultation a draft public interest condition designed to prevent or remedy the actions adverse to the public interest which the Commission found in respect of service quality. The framework of this condition was very similar to that in place at Gatwick, in that it would provide rebates to be paid where standards were not met, to be specified by the CAA in a statement on standards and rebates, which would be capable of being modified during Q5 in light of changing circumstances and evidence, where need be. The CAA would intend to consult with all parties on any such proposed modification. The condition would also require Stansted Airport Limited (STAL):
- to maintain records of the actual quality of service and rebates made in such a form that performance could be independently audited

against the standards defined by the CAA; and

- to publish, monthly, on an easily accessible page on its website, its performance against the specified service standards and details of the specified rebates paid and payable in respect of each category of service;

7.10 The CAA also made a proposal for an initial Statement of Standards and Rebates which would:

- place a maximum of 7 per cent of airport charges revenue at risk;
- base the maximum amount at risk for any one element in any month at one sixth of the annual amount at risk for that element (this doubles the amount at risk for any one failure, versus a uniform monthly application of rebates, but exhausts the maximum amount at risk for the year for that element after 6 rather than 12 months);
- adopt the standard for central security queues recommended by the Commission (i.e. queues should be no longer than 10 minutes on at least 95 per cent of occasions measured); and
- allocate 1.5 per cent (out of the 7 per cent total) to central security search and 0.5 per cent to each of: departure seat availability; cleanliness; way-finding; flight information; passenger sensitive equipment; and arrival baggage reclaim.

7.11 These weightings were modified from those in the Gatwick scheme on the following counts:

- to take account of comments raised by the Commission, in particular to recognise the particular significance of security queue performance in the Commission's public interest finding for Stansted; and the Commission's recommendation that the CAA should consider increasing the weighting attached to the four passenger related factors based on the QSM;
- to take account of the changed scope of the scheme to fewer standards; and
- to have regard to presenting rounded numbers in the context of Stansted where appropriate.

7.12 The CAA did not allocate the remaining 2.5 per cent of rebates at risk between what it considered the more airline-facing elements in the Gatwick framework. The CAA said that it would be looking to the views of the airlines on the relative importance of these measures (or indeed whether airlines would prefer some of this money at risk to be used to increase the money at

risk to any of the other elements above which have a critical impact on their business e.g. central security queues).

7.13 A further issue surrounded the standard for departure lounge seat availability. The CAA did not propose to set the QSM target for departure lounge seat availability to the same level (3.8) as at Gatwick, in light of:

- the removal of the Departures Extension project from the baseline capex on which the Commission's price control profile was based: without this project, the CAA understands that there may be limited scope to improve passenger perceptions of seating; and
- the implications of the 'stretch targets' for retail revenue, embodied within the Commission's price cap recommendations, which rely to some extent on increased airside dwell time and hence greater pressure on space in the departures lounge.

7.14 The CAA invited the views of STAL, airlines and other interested parties on a suitable target for this aspect of passenger service quality.

Consultation responses

Air Transport Users Council

7.15 The AUC believed that the introduction of a service quality rebate regime was the right decision for passengers, even if only as a precautionary measure. It supported the CAA's proposals for the public accountability of performance at Stansted. It agreed that independent audit of BAA's records of quality of service and rebates should be integral to the scheme. It believed that publication on the BAA website and in the terminal at Stansted would be equally important because of the discipline that comes from public scrutiny.

7.16 The AUC was not in a position to offer independent evidence of the impact of the scheme at Gatwick. But it makes sense for the Gatwick scheme to be used as a point of reference for Stansted. It accepted that it may not be sensible to use identical measures for the two airports, and noted that the CAA was proposing a lower standard at Stansted for departure lounge seating availability. The AUC believed that it would not make sense to set the departure lounge seat availability standard unattainably high, but the standard should, at the same time, be challenging for the airport and aim to achieve a reasonable measure of satisfaction for passengers. It would therefore make sense to set the standard by reference to as many existing relevant measures and points of reference as possible.

7.17 The AUC endorsed the CAA's proposal not to include bonuses in the Stansted SQR.

Other passenger views

7.18 The CAA received comments from a Stansted passenger, Mr Robertson, who commented adversely on the length of the security queues at the airport and the manning of the security search lanes. He suggested higher financial penalties on the airport for persistent under-performance in service delivery.

SACC

7.19 The SACC welcomed the Commission's public interest finding in relation to service quality and the CAA's proposed condition to remedy the adverse effects. It did not view the SQR regime opportunistically as a means to reduce excessive airport charges. It considered the key objectives to be:

- to address areas of performance with an immediate and consequential impact on the passenger process;
- to influence tactical and medium term management and supervisory decisions to improve performance.

7.20 The SACC believed strongly that the service quality rebate scheme should focus primarily on those areas which were the main areas of passenger detriment (and complaint), namely outbound security search and outbound baggage. These two areas gave rise to the greatest levels of delay and disruption and for which failures can have considerable knock-on consequences, potentially impacting on flights throughout a day as a consequence of delayed departures during the peak period. The SACC believed that the majority of any rebates should be targeted to failures in these two areas, and be set at a level which provided an effective incentive on STAL to avoid failures in this area.

7.21 Conversely, the SACC considered that some of the service measures were not currently giving rise to issues of concern to airlines or passengers at Stansted, such as arrangements for staff search, but that other aspects such as cleanliness or availability of passenger sensitive equipment had the potential to impact adversely on the passengers' experience. The SACC considered these other measures should all be included within a basket accounting for a minority but still sizeable proportion of the overall financial value of the potential penalties. The precise weightings of items within this basket would be agreed between STAL and the SACC annually to reflect current service priorities at Stansted. Within this basket, it would be possible for some items to be set at 0 per cent or, indeed, a single item to be set at 25 per cent. The SACC had been in discussion with STAL regarding the structure of the SQR scheme and submitted a joint paper detailing the structure and weightings, having regard to passenger complaints to airlines and to the airport.

7.22 The SACC welcomed the CAA's proposal not to apply a bonus term.

BAA Stansted Airport

7.23 STAL accepted the CAA's proposals that there should be an SQR scheme. It noted that good progress had been made in discussions with the airlines on the details of the scheme and that agreement had been reached on a rebate weighting to the elements of: passenger security queues 65 per cent; outbound baggage 10 per cent; and remaining measures 25 per cent. It noted that the inclusion of outbound baggage represented an additional commitment by the airport and both this measure and security queuing would also be subject to further penalties in the event of an extensive failure that impacted airline operations. The remaining measures would form a basket subject to an overall rebate of 25 per cent of the total⁸⁰.

Joint Proposal by SACC and STAL

7.24 The SACC and STAL made a joint proposal to the CAA for the scope and design of the SQR regime. This was set out in:

- the summary of a joint workshop, attached to the SACC submission; and
- a more detailed description of processes, submitted by STAL, setting out how each element would be measured, over what time periods, with contingency arrangements and the exclusions that would apply. This has been agreed by the SACC.

CAA assessment

7.25 The CAA welcomes the constructive approach of the SACC and airport operator to agreeing a set of standards and rebates addressing areas of performance with an immediate and consequential impact on the passenger experience.

7.26 While the CAA put forward a scheme in its December proposals broadly based on the Gatwick scheme, it recognises that the scheme needs to be tailored to the particular needs and priorities of passengers and airlines at Stansted. In the light of the particular importance of low-cost no-frills services at Stansted, the CAA acknowledges that these priorities are likely to be heavily tilted to those processes which are critical to the fast and predictable turnarounds at the heart of this business model. The CAA agrees that passengers and airlines both have a fundamental requirement for these processes to be delivered in a manner that enables low cost air transport.

7.27 In its December proposals, the CAA left 2.5 per cent out of the 7 per cent of monies at risk to be allocated, based on airline priorities, to a number of what the CAA described as 'airline-facing measures' (including various measures of asset availability). The CAA also noted the option for the airlines to choose

⁸⁰ STAL also made some detailed drafting points.

to increase the financial incentives to good service performance in passenger security search or other areas to which the CAA had already allocated monies at risk. In the event, the joint proposal by the SACC and STAL only allocates 0.7 per cent to the elements that the CAA described as 'airline-facing', has allocated 0.7 per cent to a new element based on the availability of outbound baggage systems, and has used the remainder to increase the monies at risk on central security. Moreover, the joint proposal implies a substantial reallocation from some of the other 'passenger-facing' elements towards central security search. The extent of these changes is set out in Table 7-1 below and the merits of making such a reallocation are considered further below, in light of the joint proposal in the round.

7.28 The CAA accepts that the general thrust of the proposals, to place major emphasis on central security queuing and the introduction of an outbound baggage measure, is consistent with furthering the reasonable interests of users of airports within the UK and promoting efficient, economic and profitable airport operations. Moreover, in the context of the public interest finding, the much stronger weight on the central security queuing addresses more closely the emphasis placed on this element of service by the Commission itself.

7.29 The outbound baggage system is clearly an important factor in ensuring smooth aircraft turnarounds and consequently an important factor in the punctuality, resilience and cost of providing a service on which passengers place substantial value. The CAA considers that introducing a standard at Stansted where there is a relatively uniform system for users within a single terminal is practicable and it therefore considers it appropriate to introduce this measure to the SQR scheme. The SACC and airport have mutually agreed an availability standard of 99 per cent and the CAA considers it appropriate to endorse this standard. In light of the emphasis placed on this measure for passenger the CAA has also decided to add it to the categories of service qualities for which the airport is required to publish performance monthly as described in paragraph 7.9.

7.30 The joint proposal also proposed the following modifications to the CAA's consultation proposals:

- introducing a concept that the weights and standards of the 25 per cent of the scheme other than central security search and outbound baggage system would be reviewed annually with a view to shifting the emphasis to elements where there was a demonstrated need;
- basing the scale of annual rebates on reaching the annual maximum in 12, rather than 6, months of failure;
- supplementary rebates for central security search and outbound baggage for periods of short but very disruptive failure (queues of greater than 30 minutes or a baggage system outage of more than 30

minutes where the airline is not offered an alternative check-in desk with a working system within 15 minutes);

- central security queuing measurement to be based on the percentage of passengers receiving a level of service rather than the percentage of time that a service level is reached – with the measurement of queues based to a large extent on automated technology; and
- replacing the standard and rebate for lounge seat availability with a standard and rebate directed solely at seat availability for passengers with reduced mobility (PRMs).

- 7.31 The CAA addresses each of these proposed modifications in turn.
- 7.32 With regard to the basket of service measures, the CAA recognises that there may be more influence on service performance over a wide range of quality dimensions if the weighting and standards can be adjusted dynamically to address particular areas of deteriorating quality. It also recognises that it may be a less effective use of the amount of monies at risk if they are allocated to measures which are consistently performing excellently, to the satisfaction of airlines and passengers. The CAA also notes that the 'basket allocation' approach has been agreed by the airport, and the CAA therefore considers that any risks to the airport from changing standards are expected to be outweighed in benefits to the management of the airport and its relationship with its customers.
- 7.33 The CAA has therefore decided to endorse this approach. It would, however, reserve the right to withhold approval of proposed modifications, and to implement changes of its own following appropriate consultation processes, if it believed that this were necessary to remedy the public interest finding made by the Commission.
- 7.34 With regard to the monthly allocation of rebates, the CAA has applied similar schemes at Heathrow and Gatwick in which it has set the monthly rebates as a sixth of the maximum annual rebate for each rebate rather than a twelfth. This has the effect of leveraging up by a factor of two the rebates relating to any one month of failure, but has the offsetting effect of exhausting the monies at risk for chronic underperformance after six poor months. The CAA considered that other mechanisms, such as greater public profile on persistent failure, would come into play to influence airport management when service performance was chronically poor – and the CAA has introduced the systematic publication of such poor performance, alongside airport plans to remedy the same, at Heathrow and Gatwick.
- 7.35 The package of measures in the joint proposal has been agreed on the basis of monthly rebates one twelfth rather than one sixth of the annual maximum. While the CAA still believes that there is merit in some circumstances in leveraging up the power of the incentives, it does not believe that it would be

appropriate to undermine the basis of this agreed package by challenging such a fundamental assumption. The CAA has therefore decided to accept this aspect of the joint proposition. The CAA has also taken advantage of this to specify the rebates wholly in monthly terms. This has the advantage of being generally simpler and of not requiring an annual reconciliation particularly where there is the added complication of a difference in timing between the charging and the financial year.

- 7.36 With regard to the additional rebates for severe disruption, the CAA recognises that the broad brush measures in the scheme that it proposed may not capture severe operational disruptions arising from relatively short but severe disruption, particularly to passenger processing. The CAA therefore considers that agreed daily standards are likely to improve both the incentives in the scheme and the support of airlines for the service quality regime. The CAA has therefore decided to accept these proposals as part of the scheme. The daily rebates would be subject to the overall monthly and annual limits for the passenger security processing and outbound baggage rebates, as agreed by the airlines and airports.
- 7.37 With regard to queue measurement, the CAA endorses the use of automated technology, and its use in framing the central security search standard in terms of the percentage of passengers that receive a certain queuing standard rather than the percentage of time where the standard is not met.
- 7.38 With regard to provision of passenger seating, the CAA set out in its December proposals that there were questions of consistency to address between service standards and airport's existing and planned terminal facilities. The CAA invited the parties to consider this. The joint proposal has made a fundamental change in the nature of this measure from a standard of departure seat availability for passengers as a whole, as measured through the QSM, to the percentage of departure lounge (and catering facility seats) which are clearly designated as being for passengers with reduced mobility.
- 7.39 The CAA considers that this is one area where the passengers' interests may not be aligned with those of either the airlines or the airport. The airport would, all other things being equal, have an interest in passengers spending in the shops or catering concessions rather than sitting in the departure lounge area while the airlines may have an operational interest in passengers moving to gate rooms at the earliest opportunity. Many passengers, though, are likely to value being able to sit down in the departure lounge – earlier research which informed the establishment of the SQR schemes at Heathrow and Gatwick in 2003 suggested that seating availability was an important factor for passengers in their through-airport experience.
- 7.40 The CAA is therefore not inclined to omit a measure of departure lounge seating from the SQR scheme. In addition, while the availability of seating will be critically important to some passengers with reduced mobility, the percentage measure proposed does not appear to be appropriate: it could for

example be 'improved' artificially by reducing the denominator of the number of departure lounge seats overall as well as by increasing the numerator of the number of seats reserved for PRMs. Moreover, the seats involved appear to be only of the order of 35 across the whole of the airport and it seems likely that standards could be maintained other than as part of the standards and rebates scheme. The CAA has therefore decided to implement a measure of departure lounge availability measured by the QSM in the scheme. The CAA notes that the average score of 3.8 may be unduly testing (given the current and projected constraints on terminal departures facilities). It has therefore sought to set a standard which should be achievable in a congested terminal. It notes that the achieved QSM score for the year ending July 2008 was 3.5 and has made a downward adjustment in the proposed standard to 3.5.

- 7.41 The CAA notes that the standards of service put forward for Cleanliness, Way-finding and Flight Information put forward jointly by the airport and the SACC each have a QSM score that is 0.1 per cent lower than the CAA proposed in its consultation document. The CAA's inspection of QSM performance for the year ending July 2008 suggests that the airport was meeting the higher standard for Way-finding and Flight information in most areas but the airport was not meeting the higher cleanliness target – particularly for arrivals. The CAA has therefore decided to confirm its own proposed targets. The CAA notes that cleanliness is the area on which the SACC has put the highest weight after security queues and outbound baggage. The CAA has decided on balance to confirm the earlier standard proposed in December. The CAA also notes that the detailed specification of the cleanliness measure would limit it to the measure for 'Departures – Overall Cleanliness'. This is different from the CAA's proposal that the measure would relate to 'a weighted average of the QSM scores for cleanliness questions, weighted by the proportion of passengers using each type of facility'. The CAA considers that, in the interest of passengers, the measure should relate to cleanliness in arrivals as well as departure areas and has made this revision to the specification.

Reweighting

- 7.42 The CAA has considered whether the decrease in the monies at risk for the areas which are passenger-facing is better calculated to remedy the public interest finding made by the Commission – particularly in respect of the QSM measures where the Commission specifically recommended that the CAA should increase the relative weighting compared to Gatwick.
- 7.43 Table 7-1 sets out the effects of the re-weighting proposed by the joint proposal compared to both the CAA's proposal for consultation and the scheme at Gatwick.

Table 7-1 Service quality rebate allocation

	Percentage of airport charge revenue at risk		
	December proposal	Airline/Airport Joint proposal	SQR Gatwick
Central security	1.5	4.55	0.77
Outbound baggage		0.70	
QSM			
Departure seat availability	0.50	0.07	0.36
Cleanliness	0.50	0.35	0.36
Way-Finding	0.50	0.14	0.36
Flight Information	0.50	0.07	0.36
Asset Availability			
PSE	0.50	0.14	0.80
Arrivals baggage reclaim	0.50	0.28	0.40
Stands	To be decided	0.14	0.31
Jetties	To be decided	0.14	0.31
Pier service	To be decided	0.14	0.40
TTS	To be decided	0.14	0.31
FEGP	To be decided	0.14	0.22
Other security			
Transfer	To be decided	0.00	0.40
Staff	To be decided	0.00	0.31
Control post	To be decided	0.00	0.31
Aerodrome Congestion Term	N/A	N/A	1.00
Total	7.00	7.00	7.00

7.44 In setting out its conclusions on each element of the scheme the CAA has taken into account:

- that there would be an annual review of the 25 per cent basket of measures and that as a result of that review the CAA could decide to direct more of the weight of penalties to particular measures in the scheme if the CAA considered such a reweighting would be more effective in achieving the objectives of the SQR scheme;
- the performance against each measure would be measured each month even where the rebate was set at zero;
- airline and passenger interests are likely to be broadly aligned in many (but not all) areas, and that unless there is a clear misalignment of interests then the terms of package agreed between the airport operator and the SACC should be the basis for the scheme.

7.45 In respect of the QSM measures, the CAA considers that the airlines, like passengers, have a strong interest in good way-finding and flight-information

systems as these contribute to the timely progress of passengers through the airport to departure gates. The CAA believes that there is likely to be a high degree of alignment and the CAA has therefore decided to adopt the scaled back weight proposed by the airlines and airport.

- 7.46 In respect of cleanliness, there is a less clear link between passenger experience and the operational efficiency of the airlines. However, the joint proposal has broadly retained a more significant weight on this element compared to the other QSM measures. While this is reduced from the CAA's December proposals it is still broadly equivalent to the weight applied in the Gatwick SQR scheme. The CAA has decided to adopt the weighting agreed by airlines and airport, in the knowledge that the CAA could increase the weight on this measure following annual reviews if this was perceived to be a problem area.
- 7.47 The final QSM measure is departure lounge seating. The nature as well as the weighting of this element has been an issue. As set out above, the CAA has retained this element in the scheme (albeit at a lower standard at this stage than that in place at Gatwick). It has, however, decided to accept the lower weighting put on it by the airlines and airport, recognising the issues around the consistency of this service standards with the Commission's assumptions about the provision of terminal facilities. It would, however, be open to the CAA to modify this element as part of the annual review should there be evidence of the need for greater incentivisation on this element.
- 7.48 The joint proposal also implies a significant reduction in the weighting of rebates for passenger sensitive equipment and the availability of arrivals baggage carousels. These are also elements which have a much higher impact on the passenger experience rather than airport operations. However, the CAA is prepared to accept the weightings agreed by the airlines and airport, recognising that it would be open to the CAA to modify these elements as part of the annual review should circumstances warrant it.

Audits and publication of information

- 7.49 The AUC supported audits and the publication of achieved performance. The CAA confirms that it has decided to proceed with these aspects of the conditions.
- 7.50 The frequency of audits has drawn considerable attention from the Commission outside of this consultation, as part of the Commission's separate BAA Market Inquiry. The CAA proposed two audits during the course of the five-year control period for Heathrow and Gatwick, with the option of more frequent audits if the first scheduled audit suggests that a more frequent audit would be justified. The CAA continues to believe that an annual audit of the methodology of QSM may be excessive given that it is not practicable to audit the actual views of respondents. The CAA confirms that it intends to conduct two full audits with the option for additional audits, for

example, in respect of the non-QSM elements of the scheme, such as security queue measurement, if this were shown to be justified by the results of the first audit.

Exclusions

7.51 The joint STAL / SACC detailed submission described a wide range of exclusions, setting out particular periods when particular measures would be temporarily disapplied. As these have been agreed by the SACC and airport, the CAA is minded to accept the substance of these proposals, subject to the addition of some clarity, where some of the exclusions require the exercise of judgement, as to what person or body should be empowered to make that judgement. The CAA's view is that exclusions should either:

- be sanctioned by a monthly meeting of the airport and representatives of the airlines delegated by the SACC, convened to agree the relevant planned maintenance system downtime for the following month and, once agreed, this downtime would be exempt from the measurement of system availability; or
- be sanctioned by a monthly meeting of the airport and representatives of the airlines delegated by the SACC, convened to review all aspects of SQR performance and formally agree what performance measures have been met or failed; or
- where there is clear documentary evidence that an airline or its agents (e.g. handler) has admitted responsibility for a failure.

CAA decision

7.52 The CAA's decision on the remedy to the Competition Commission's public interest finding with respect to service quality is set out in a public interest condition at Annex C to this decision document. The specification of standards and rebates under this condition, to take effect from 1 April 2009, is set out in the CAA's Statement of Service Quality Standards and Rebates at Annex E to this decision document.

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8. Public interest conditions: other

Introduction

8.1 This chapter considers the condition to remedy the Competition Commission's finding that the structure of Stansted's landing charges was against the public interest, and whether the existing conditions imposed to remedy previous public interest findings, on the provision of information on non-regulated charges and turnover-related levies on off-airport catering and cleaning suppliers, should be amended or revoked.

Structure of charges

CAA's December 2008 proposals

8.2 In its December 2008 proposals, the CAA recognised that BAA had reacted positively and pro-actively to the Commission's findings and recommendations in relation to Stansted's structure of airport charges and its impact on the charges paid in Q4 by larger cargo aircraft. Stansted Airport had confirmed its intention to consult with users on a proposed structural change that addressed the Commission's concerns whereby aircraft in excess of 250 metric tonnes would be offered the same percentage discount in off-peak periods that were available to aircraft in the next lowest weight band.

8.3 The CAA considered whether, in the light of BAA's reaction to the Commission's finding, there was an argument that the imposition of a public interest condition was not necessary. However, there remained the risk that the management (or owners) of Stansted could in future during Q5 revert to the tariff structure which the Commission found against. In addition, the CAA is under a duty pursuant to Section 46(2) of the Act to impose a condition to remedy the adverse effect identified by the Commission. The CAA therefore proposed a condition that would prevent Stansted Airport from not offering an off-peak charge discount to the largest aircraft using the airport for so long as smaller aircraft attracted such a discount.

Consultation responses

8.4 The SACC welcomed and supported the CAA's proposed condition while BAA confirmed that the CAA's proposals had been incorporated into Stansted's proposed charges for 2009/10.

CAA assessment and decision

8.5 Given user support for the CAA's proposed condition and BAA's readiness to modify its charging structure in 2009/10 consistently with the CAA's proposal, the CAA has decided to impose the condition at Annex C which is in the same terms as the December 2008 proposal with one minor change. The

condition will come into force on 31 March 2009 rather than 1 April 2009 so that under paragraph 2 of the condition Stansted Airport will have to provide documentary evidence that its final charges for 2009/10 comply with the condition. In imposing this condition, the CAA has had regard to the form of the condition, specified by the Competition Commission in its report, by which the Commission considers that the adverse effects of Stansted Airport's course of conduct could be remedied or prevented.

- 8.6 The CAA would expect the condition to apply throughout Q5 but should Stansted modify its charging structure during Q5 in such a way that the condition can no longer be applied the CAA will consider whether it should be modified or revoked. In due course the CAA will also review as necessary whether the condition should be extended into Q6.

Existing public interest findings

CAA's December 2008

- 8.7 In its December 2008 proposals the CAA proposed amending the existing condition on the provision to users of information on charges for specified services. The amendments were to expand the definition of check-in desks to include facilities for self-service check-in, and to require Stansted to inform its users and the CAA if its revenue from any of the charges differed, in outturn, from that projected at the price control reviews. In March 2008, these amendments were made to the equivalent conditions on Heathrow and Gatwick.
- 8.8 The CAA also proposed revoking the condition prohibiting turnover related levies on off-airport suppliers of airline catering and cleaning services, as the levies would be prohibited under the Airports (Groundhandling) Regulations 1997 anyway. In March 2008, the equivalent conditions on Heathrow and Gatwick were revoked.

Consultation responses

- 8.9 The SACC was the only respondent which commented on the existing public interest conditions. It supported the proposed strengthening of the transparency condition for specified services, and said that it did not oppose the revocation of the turnover related levy condition.

CAA assessment and decision

- 8.10 As the only respondent supported the CAA proposals on both conditions, and no new evidence has emerged on either condition, the CAA has decided:
- to amend the transparency condition for specified services in the same terms as the December 2008 proposal with one minor change. This is to clarify that the requirement in paragraph 4 of the condition includes the year commencing 1 April 2009. The revised condition is at Annex

C; and

- to revoke the condition on turnover related levies with immediate effect.

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9. CAA decisions

- 9.1 The CAA has considered carefully all of the written responses to the proposals it published in December 2008 and the points made at the oral hearings held in February 2009. For the reasons given in this document the CAA has decided to impose price control (and other) conditions on Stansted airport consistently with its December 2008 proposals.
- 9.2 The CAA hereby imposes in relation to Stansted airport with effect from 1 April 2009:
- the charges conditions set out in Annex B in accordance with section 46(1) of the Airports Act 1986;
 - the public interest conditions as to service quality, consultation and the structure of charges set out in Annex C in accordance with section 46(2) of the Act; and
 - the modified and extended public interest condition as to cost information available to users set out in Annex C in accordance with sections 51(2) and 51(6) of the Act.
- 9.3 The CAA considers that the implementation of these conditions is best calculated to achieve the objectives of section 39 of the Act.
- 9.4 The CAA revokes the public interest condition as to the charges for airside licences at Stansted airport in accordance with section 51(6) of the Act.
- 9.5 The CAA's decisions in this document were taken by a panel of members comprising Dr Harry Bush, Mr Jim Keohane and Mr Roger Mountford, appointed for the purpose by the CAA Board.
- 9.6 This document constitutes a statement by the CAA as required by section 46(5) of the Act.

Civil Aviation Authority

13 March 2009

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Annex A. Summary of Competition Commission's conclusions and recommendations

Airport charges

- i) Airport charges at Stansted should continue to be set under a RAB-based approach.
- ii) Airport charges should be set on the basis of Stansted as an individual airport rather than on a system basis.
- iii) Airport charges should be set on a single-till basis.
- iv) Regulation should continue to be by means of RPI-X.
- v) There should not be a volume term for differences between the actual number of passengers in any year and the numbers expected when the airport charges formula was set.
- vi) Changes in airport charges should continue to be related to RPI rather than any other measure of inflation.
- vii) Regulation should continue to be on the basis of revenue yield—ie £ per passenger.
- viii) Airport charges should continue to be before any reduction of unpublished discount.
- ix) Non-passenger flights should continue to be excluded from the regulated yield, but subject to the requirement that the charges applied to such flights (eg for landing) should be the same as for similar passenger aircraft.
- x) The correction factor should be amended to allow for the recovery of an absolute amount, not an amount per passenger.
- xi) There should be no carry-over of the correction factor at Stansted at the end of Q4 into the opening year of Q5.
- xii) The security cost pass-through in Q5 should be increased to 90 per cent (subject to the dead-band of £3.6 million and subject to some subsequent efficiency adjustment).
- xiii) The capex on which the Competition Commission recommended BAA should be allowed a return in Q5 was low in the expectation that BAA would ask the CAA to undertake a mid-quinquennial review, either once it had secured planning permission for SG2 or when planning approval appeared likely.

- xiv) Overall, the Competition Commission recommended a maximum opening yield for 2009/10 of £6.26 (in 2007/08 prices, equivalent to £6.56 in 2008/09 prices), with airport charges per passenger subsequently increasing at no more than RPI+1.75 per cent in each year of Q5.

Public interest matters

The Competition Commission found BAA's conduct at Stansted between the date of the CAA's Q4 reference to the Competition Commission and the date of its Q5 reference to be against the public interest in three respects and recommended the following remedies:

- with regard to consultation relating to the strategic development of the airport and its capex proposals, improvements to the information which is provided by BAA to its airline customers and to the process of consultation;
- with regard to the quality of service, in particular the processing of passengers through security, an SQR scheme similar to the scheme in operation at Gatwick; and
- with regard to the structure of prices affecting cargo aircraft, the aircraft in the heaviest band should benefit from the same percentage discount for off-peak landing charges as applies to aircraft in the second heaviest band.

Annex B. Conditions as to airport charges imposed in relation to Stansted Airport Ltd in accordance with section 40(4) of the Airports Act 1986

STANSTED CONDITION 1

1. When the airport operator fixes the amounts to be levied by it by way of airport charges in respect of relevant air services in the year beginning on 1 April 2009 it shall fix those charges at the levels best calculated to secure that, in that year, the total revenue at Stansted airport from such charges divided by the total number of passengers using Stansted airport, does not exceed the maximum average revenue yield per passenger which shall be calculated as follows:

$$M_{2009/10} = \text{£}6.53$$

Where $M_{2009/10}$ is the maximum average revenue yield per passenger using Stansted airport in relevant year 2009/10 expressed in £.

2. When the airport operator fixes the amounts to be levied by it by way of airport charges in respect of relevant air services in the year beginning on 1 April 2010 it shall fix those charges at the levels best calculated to secure that, in that year, the total revenue at Stansted airport from such charges divided by the total number of passengers using Stansted airport, does not exceed the maximum average revenue yield per passenger which shall be calculated as follows:

$$M_{2010/11} = \left(1 + \frac{RPI_{t-1} + X}{100} \right) (\text{£}6.53 + S_{t-1})$$

Where:

$M_{2010/11}$ is the maximum average revenue yield per passenger using Stansted airport in relevant year 2010/11 expressed in £;

RPI_{t-1} has the meaning assigned to it by paragraph 7;

$X = 0$; and

S_{t-1} has the values assigned in paragraph 5.

3. On each occasion on which the airport operator fixes the amounts to be levied by it by way of airport charges in respect of relevant air services in each of the three relevant years beginning with 1 April 2011 it shall fix those charges at the levels best calculated to secure that, in each relevant year, the total revenue at Stansted airport from such charges, divided by the total number of passengers using Stansted airport, does not exceed the maximum

revenue yield per passenger calculated in accordance with the following formula:

$$M_t = \left(1 + \frac{RPI_{t-1} + X}{100}\right) Y_{t-1} - K_t$$

Where:

M_t is the maximum average revenue yield per passenger using Stansted airport in relevant year t expressed in £;

RPI_{t-1} has the meaning assigned to it by paragraph 7;

$X = 1.63$

Y_{t-1} has the meaning assigned to it by paragraph 4; and

K_t has the meaning assigned to it by paragraph 6.

4. Y_{t-1} is the specified average revenue yield per passenger calculated in accordance with the following formula:

$$Y_{t-1} = Y_{t-2} \left(1 + \frac{RPI_{t-2} + X}{100}\right) + S_{t-1}$$

Where:

$Y_{2009/10} = £6.53 + S_{t-1}$ for the relevant year beginning on 1 April 2011;

RPI_{t-2} has the values assigned in paragraph 7;

$X = 1.63$; and

S_{t-1} has the values assigned in paragraph 5.

5. S_{t-1} is the allowable security cost per passenger using Stansted airport in relevant year t-1 (whether of a positive or a negative value) to be applied in relevant year t calculated in accordance with the following formulae expressed in £:

for each relevant year t-1

If

Expected Cumulative Costs_{t-1} ≥ £3.6 million; and
Expected Cumulative Costs_{t-2} ≥ £3.6 million

then

$$S_{t-1} = 0.9C_{t-1}$$

or if

Expected Cumulative Costs_{t-1} > £3.6 million; and

Expected Cumulative Costs_{t-2} < £3.6 million

then

$$S_{t-1} = 0.9 \frac{\text{Expected Cumulated Cost}_{t-1} - 3.6 \text{ million}}{(6 - T_t) Q_{t-1}}$$

or if

Expected Cumulative Costs_{t-1} < £3.6 million; and
Expected Cumulative Costs_{t-2} > £3.6 million

then

$$S_{t-1} = -0.9 \frac{\text{Expected Cumulated Cost}_{t-2} - 3.6 \text{ million}}{(6 - t^*) Q_{t-1}}$$

Where

$$t^*_{2009/10} = 1; t^*_{2010/11} = 2; t^*_{2011/12} = 3; t^*_{2012/13} = 4; \text{ and } t^*_{2013/14} = 5$$

otherwise

$$S_{t-1} = 0$$

and where the expected cumulative cost of annualised claims shall be calculated as follows:

Year (t-1)	2009/10	2010/11	2011/12	2012/13
A. Effect of claims relating to 2009/10	5 x C _{2009/10} x Q _{2009/10}	5 x C _{2009/10} x Q _{2009/10}	5 x C _{2009/10} x Q _{2009/10}	5 x C _{2009/10} x Q _{2009/10}
B. Effect of claims relating to 2010/11		4 x C _{2010/11} x Q _{2010/11}	4 x C _{2010/11} x Q _{2010/11}	4 x C _{2010/11} x Q _{2010/11}
C. Effect of claims relating to 2011/12			3 x C _{2011/12} x Q _{2011/12}	3 x C _{2011/12} x Q _{2011/12}
D. Effect of claims relating to 2012/13				2 x C _{2012/13} x Q _{2012/13}
Expected Cumulative Cost Sum rows A to D				

Where:

C_{t-1} is the total qualifying security claims per passenger using Stansted airport in relevant year t-1 (whether of a positive or a negative value) expressed in £; and

Q and Q_{t-1} = passengers using Stansted airport in the relevant year.

6. K_t is the correction per passenger (whether of a positive or negative value) to be made in relevant year t which is calculated as follows:

$$K_t = \frac{T_{t-2} - (Q_{t-2}M_{t-2})}{Q_t} \left(1 + \frac{I_{t-2}}{100} \right)^2$$

in which

T_{t-2} = total revenue from airport charges in respect of relevant air services levied at Stansted airport in relevant year $t-2$;

Q_{t-2} = passengers using Stansted airport in relevant year $t-2$;

Q_t = passengers using Stansted airport in relevant year t ;

M_{t-2} = maximum average revenue yield per passenger using Stansted airport in relevant year $t-2$;

I_{t-2} = the appropriate interest rate for relevant year t-2 which is equal to, where K_t (taking no account of I for this purpose) has a positive value, the Specified Rate plus three percentage points or, where K_t (taking no account of I for this purpose) has a negative value, the Specified Rate.

7. In this condition:

“airport charges” has the meaning assigned to it by section 36(1) of the Airports Act 1986;

“airport operator” means the person for the time being having the management of Stansted airport;

“average revenue yield per passenger” means the revenue from airport charges levied in respect of relevant air services in the relevant year before any deduction of unpublished discounts or payments under Service Level Agreements divided by the total number of passengers using Stansted airport in the relevant year;

“passenger using an airport” means a passenger joining or leaving an aircraft at Stansted airport;

“qualifying security claim per passenger” means the annual equivalent of the increase or decrease in security costs at Stansted airport in the relevant year t-1, which arise as a result of a change in required security standards at that airport, as certified by the Civil Aviation Authority, divided by the number of passengers using the airport in that year;

“relevant air services” means air services carrying passengers that join or leave an aircraft at Stansted airport, including air services operated for the purpose of business or general aviation;

“relevant year” means the period of twelve months ending with 31 March in each year;

“ RPI_{t-1} ” means the percentage change (whether of a positive or negative value) in the Retail Price Index between that published with respect to August in relevant year t-1 and that published with respect to the immediately preceding August, and “ RPI_{t-2} ” shall be construed accordingly;

“Specified Rate” means the average of the Treasury Bill Discount Rate (expressed as an annual percentage interest rate) published weekly by the Bank of England, during the 12 months from the beginning of September in year t-2 to the end of August in year t-1.

STANSTED CONDITION 2

In each of the five consecutive years beginning on 1 April 2009 the operator of Stansted airport shall not levy airport charges in respect of air services that do not fall within the definition of relevant air services for the purposes of Condition 1 that are higher than are levied in respect of equivalent air services falling within that definition.

Annex C. Public interest conditions

Conditions as to the arrangements for consultation by Stansted Airport Limited with airlines in accordance with section 46(2) of the Airports Act 1986

WHEREAS the Competition Commission (“CC”) in its report to the Civil Aviation Authority (“CAA”) following a reference made by the CAA to the CC on 29 April 2008 in respect of Stansted Airport Limited (“STAL”) concluded that STAL’s conduct with regard to consultation at Stansted since 1 April 2003 had operated against the public interest;

AND WHEREAS the CC found that the consultation process, with regards to the development of the airport and STAL’s capital expenditure programme failed and that this failure had adverse effects both on the charges levied in the period 1 April 2009 to 31 March 2014 and on the operational activities of the airport and its users;

AND WHEREAS the CC found that STAL’s failure with regard to information provision and the process of consultation had adverse effects on the management and development of Stansted Airport and specifically on:

- (a) the operational activities of the airport and its users which affected directly the price paid by the users of the airport in airport charges and the operational efficiency and effectiveness of the airport, both of which affect users’ reasonable interests, including the interests of possible future users; and
- (b) the efficiency of capital expenditure, which also affected directly the price paid by users of the airport in airport charges and so affected users’ reasonable interests.

AND WHEREAS the CC believed these adverse effects could be remedied through the imposition on STAL of conditions;

AND WHEREAS the CC recommended that conditions should be imposed on STAL in relation to the information provided as a basis for consultation and in relation to the process of consultation;

AND WHEREAS the CAA has had regard, as required by section 46(4) of the Airports Act 1986 (“the Act”), to the recommendations made by the Competition Commission as to the conditions by which the effects adverse to the public interest could be remedied or prevented;

AND WHEREAS the CAA has powers to impose conditions on STAL as the operator of Stansted Airport;

NOW THEREFORE the CAA, in exercise of its powers and duties under section 46(2) of the Act hereby imposes the following conditions on STAL:-

1. STAL shall provide information to, and conduct consultation with, airline users of Stansted Airport with regards to the development of Stansted Airport and STAL's capital expenditure programme in such form and at such times as may be specified from time to time by the CAA following consultation with STAL and its users.
2. STAL shall, to a reasonable extent, co-operate with any independent facilitator initially appointed by the CAA in the resolution of disputes and other matters relating to the operation of condition 1. The purpose of the facilitator is to facilitate consultation between STAL and users under condition 1.
3. These conditions shall take effect on 1 April 2009 and shall continue in force until 31 March 2014 unless, before that date, they are modified or withdrawn.

These conditions may be extended beyond 31 March 2014 in accordance with section 51(2) of the Act.

Conditions as to rebates to be paid by Stansted Airport Limited to users where quality of service fails to meet service standards in accordance with section 46(2) of the Airports Act 1986

WHEREAS the Competition Commission (“CC”) in its report to the Civil Aviation Authority (“CAA”) following a reference made by the CAA to the CC on 29 April 2008 in respect of Stansted Airport Limited (“STAL”) concluded that security queue management during 2003, 2005 and 2006 constituted a course of conduct which had operated against the public interest;

AND WHEREAS the CC’s analysis of passenger survey data relating to service quality suggested that performance overall had been declining, although there was some evidence of recent improvement, and that Stansted ranked poorly in international benchmarking surveys;

AND WHEREAS the CC found that there were adverse effects on the operational activities of the airport in relation to service quality, in particular with regard to security queue management, which directly affected both the reasonable interests of users and the operational effectiveness of the airport;

AND WHEREAS the CC believed these adverse effects could be remedied through the imposition on STAL of a requirement to meet specified service standards;

AND WHEREAS the CC recommended that a condition should be imposed on STAL which establishes queue standards, backed by penalties in the event that the standards are not met;

AND WHEREAS the CC recommended that a condition should be imposed on STAL requiring a Service Quality Rebate scheme to be introduced at Stansted Airport;

AND WHEREAS the CAA has had regard, as required by section 46(4) of the Airports Act 1986 (“the Act”), to the recommendations made by the Competition Commission as to the conditions by which the effects adverse to the public interest could be remedied or prevented;

AND WHEREAS the CAA has powers to impose conditions on STAL as the operator of Stansted Airport;

NOW THEREFORE the CAA, in exercise of its powers and duties under section 46(2) of the Act hereby imposes the following conditions on STAL:-

1. STAL shall pay specified rebates to airlines whenever its quality of service fails to meet specified service standards. The specified service standards and rebates shall be as published from time to time by the CAA following consultation with STAL and its users.

2. STAL shall maintain records of the actual quality of service and rebates made in such a form that performance could be independently audited against the standards published as above.
3. STAL shall publish, monthly, on an easily accessible page on its website its performance against the specified service standards and details of the specified rebates paid and payable in respect of each category of service.
4. STAL shall publish, monthly, through prominent displays in the terminal at Stansted Airport, its performance against such specified service standards as the CAA shall from time to time nominate for the purpose of better informing passengers.
5. STAL shall facilitate regular independent audits of the measurement and working of the service quality regime, including the QSM methodology. Audits of the QSM should ensure that it is in accord with best market practice, and that the methodology is adequately implemented to make sure that samples reasonably reflect the overall mix of passengers. The independent auditors for this purpose will be appointed by the CAA and shall report to the CAA.
6. These conditions shall take effect on 1 April 2009 and shall continue in force until 31 March 2014 unless, before that date, they are modified or withdrawn.

These conditions may be extended beyond 31 March 2014 in accordance with section 51(2) of the Act.

Conditions as to the structure of airport charges levied by Stansted Airport Limited in accordance with section 46(2) of the Airports Act 1986

WHEREAS the Competition Commission (“CC”) in its report to the Civil Aviation Authority (“CAA”) following a reference made by the CAA to the CC on 29 April 2008 in respect of Stansted Airport Limited (“STAL”) concluded that the current structure of landing charges at Stansted, which failed to give off-peak discounts to aircraft in excess of 250 metric tonnes, had no basis and had been operating against the public interest;

AND WHEREAS the CC found that there were adverse effects concerning the charges levied by the airport which affected directly the reasonable interests of some users;

AND WHEREAS the CC believed these adverse effects could be remedied through the imposition on STAL of a requirement to offer a reasonable off-peak discount for aircraft in excess of 250 metric tonnes;

AND WHEREAS the CC recommended that a condition should be imposed on STAL which would require it to offer an aircraft in the highest weight band at Stansted (aircraft in excess of 250 metric tonnes) at least the same level of off-peak discount on landing charges as the discount offered in the next lower weight band (aircraft in excess of 50 metric tonnes but below 250 metric tonnes);

AND WHEREAS the CAA has had regard, as required by section 46(4) of the Airports Act 1986 (“the Act”), to the recommendations made by the Competition Commission as to the conditions by which the effects adverse to the public interest could be remedied or prevented;

AND WHEREAS the CAA has powers to impose conditions on STAL as the operator of Stansted Airport;

NOW THEREFORE the CAA, in exercise of its powers and duties under section 46(2) of the Act hereby imposes the following conditions on STAL:-

1. This condition shall apply when and for so long as STAL fixes its airport charges for the landing of aircraft so that the charge levied for landing an aircraft in excess of 50 tonnes but below 250 metric tonnes during a peak period is higher than the charge levied for landing at other times. Where this condition does apply, the charges levied for landing aircraft in excess of 250 metric tonnes shall, at all times, bear the same relationship to the equivalent charges levied on aircraft in excess of 50 metric tonnes but below 250 metric tonnes.
2. By 31 March each year STAL shall provide documentary evidence to the CAA that Condition 1 has been satisfied in respect of the following charging period.

3. These conditions shall take effect on 31 March 2009 and shall continue in force until 31 March 2014 unless, before that date, they are modified or withdrawn.

The conditions may be extended beyond 31 March 2014 in accordance with section 51(2) of the Act.

Conditions as to the cost information available to users in respect of Stansted Airport Limited in accordance with section 46(2) of the Airports Act 1986

WHEREAS the Monopolies and Mergers Commission ("MMC") in the report made to the Civil Aviation Authority ("CAA") following a reference made by the CAA to the MMC on 13 December 1990 in respect of Stansted Airport concluded that in providing to users inadequate information on the costs or other bases for charges of a number of services and facilities for airlines, tenants and licensees Stansted Airport Limited ("STAL") had pursued a course of conduct which may be expected to operate against the public interest;

AND WHEREAS the MMC specified in its report that the CAA should impose conditions to require STAL to provide on an annual basis or at the time of each price increase information to the CAA and users on the detailed costs or other factors on which such charges are based;

AND WHEREAS the CAA had regard, as required by section 46(4) of the Airports Act 1986 ("the Act"), to the recommendations made by the MMC as to the conditions by which the effects adverse to the public interest could be remedied or prevented;

AND WHEREAS the CAA imposed conditions on 18 November 1991;

AND WHEREAS the Competition Commission ("the CC") in the report made to the CAA following a reference made by the CAA to the CC on 29 April 2008 in respect of Stansted Airport recommended that the CAA should extend to Stansted Airport the requirements for transparency in relation to charges for non-airport charges activities;

NOW THEREFORE the CAA, in exercise of its duties under section 46(2) of the Act hereby imposes the following modified conditions on STAL:-

1. By 31 December 2009 and by 31 December in each subsequent year STAL shall inform the CAA of the system used by it to allocate costs to non-airport charges activities. STAL shall make any amendments to its cost allocation system if so requested by CAA by 31 March prior to each charging year commencing on 1 April.
2. By 31 December 2009 and by 31 December in each subsequent year STAL shall provide to the CAA statements of actual costs and revenues in respect of each of the facilities specified in paragraph 8 for the year ending the previous 31 March.
3. Each year STAL shall provide to the CAA and to users or organisations representing users of the specified facilities prior to implementing any price changes a statement of the pricing principles for each item charged.
4. Each year including the year commencing 1 April 2009 STAL shall provide the CAA and users or their representatives the assumptions and relevant

cost information adequate to verify that the charges derive from the application of the pricing principles.

5. Where the costs stated by STAL to be in connection with a particular charge vary from those provided in the Profit Centre Reports supplied to the CAA, STAL shall provide to the CAA and to users or their representatives a reconciliation with detailed reasons for such differences.
6. Where charges for the specified facilities are not established in relation to cost STAL shall provide to the CAA and to users or their representatives a statement of the principles on the basis of which the charges have been set with full background information as to the calculation of such charges including statements of any comparables used.
7. Where in respect of any year outturn revenue from any of the specified facilities differs from that forecast for the purposes of the price control review for the period 1 April 2009 to 31 March 2014 (as specified by the CAA⁸¹), STAL shall provide to the CAA and to users or their representatives detailed reasons for the differences.
8. The specified facilities are: check-in desks (including facilities provided for self service check-in), baggage systems, other desk licences, staff car parking, staff ID cards, fixed electrical ground power, hydrant refuelling, airside parking, airside licences, cable routing, maintenance, heating and utility services, and facilities for bus and coach operators.
9. These modified conditions shall take effect from 1 April 2009 and shall continue in force until 31 March 2014 unless, before that date, they are modified or withdrawn.

The conditions may be extended beyond 31 March 2014 in accordance with section 51(2) of the Airports Act 1986.

⁸¹ In Appendix 1 to this condition

Appendix 1 to the Conditions as to the cost information available to users in respect of Stansted Airport Limited in accordance with section 46(2) of the Airports Act 1986

CAA projections of non-regulated charges at Stansted

£ millions 2007/08 prices	2009/10	2010/11	2011/12	2012/13	2013/14	Q5 total
Specified activities						
Check-in desks	3,225	3,405	3,585	3,840	4,050	18,105
Staff car parking	1,125	1,135	1,145	1,155	1,165	5,725
Gas	30	30	30	30	30	150
Water & sewerage	335	321	309	288	257	1,509
Electricity	6,694	6,302	6,024	5,772	5,327	30,118
Security ID passes	268	270	272	274	276	1,360
Fixed electrical ground power	503	537	563	596	615	2,815
Hydrant refuelling	1,720	1,816	1,912	2,048	2,160	9,656
Specified activities total	13,900	13,815	13,840	14,003	13,880	69,438

Source: Stansted Airport Limited

Not all of the specified facilities in paragraph 8 of the condition are included in the table. This is because the airport does not levy a separate charge on all of the facilities.

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Annex D. Information protocol

Introduction

1. This annex sets out the CAA's guidance to support the public interest condition on the facilitation of consultation at Stansted Airport. This Information Protocol is a statement by which the CAA defines the scope of information that should reasonably be exchanged during consultation by Stansted Airport Limited (STAL) during Q5, in accordance with the public interest condition on consultation⁸². It also articulates requirements that the parties and the facilitator (to be appointed under the same public interest condition) should adhere to in coming to an agreement on processes and the timing of consultation during Q5.
2. The CAA has developed this proposed protocol having had regard to the Competition Commission's analysis, findings and recommendations in respect of consultation by BAA at Stansted during Q4. It has also taken account of the responses received from BAA and from the Stansted Airlines Consultative Committee.
3. While this information protocol, along with the associated public interest condition, is designed to govern the behaviour of STAL (as the regulated airport), the CAA considers that it is appropriate that airlines meet the airport's reasonable expectations regarding information that STAL itself requires to support effective consultation. The CAA recognises that effective consultation can only be delivered with the active participation of both STAL and its airline users. The CAA considers that the airport and airlines need to respect the agreed process and timescales when making their contributions. Where airlines cannot provide inputs in time, the airport may need to make informed assumptions that can be adjusted through subsequent consultations if necessary. It may also be necessary to revise assumptions later. The CAA considers, though, that each party should aim to ensure that any delays, which may arise from airlines' limited resources, do not unduly jeopardise STAL's ability to deliver its investment programme or specific projects or the operational needs of airlines.

Context

4. Since December 2008, the CAA has held discussions with a sample of airports and airlines, other airport users, and consultants in the industry. The focus of discussion has been airport / airline consultations in the United Kingdom. The intent of the discussions is to build a more detailed understanding of the issues and pressures that influence negotiations between the parties in order to inform both the public interest condition at Stansted Airport and future work related to the European Union Directive on Airport Charging.

⁸² Set out in Annex C to the CAA's decision document on economic regulation of Stansted Airport in the five-year period starting 1 April 2009

5. Further, the CAA makes the reasonable assumption that regardless of the specific context, airports and airlines need to develop close working relationships to ensure the ongoing efficient and effective operation of their respective businesses. In addition, although airport owners have ultimate responsibility for developing airport infrastructure, it is in their interests to consult effectively with airport users, to ensure as far as practicable their plans for future airport developments meet users' needs, for example to ensure capital expenditure can be remunerated from passenger flows.
6. The discussions confirmed that a degree of tension in negotiations over future development is to be expected, and that it is not uncommon for there to be unresolved disagreements between the parties. While this might in certain circumstances be the result of ineffective consultation, there might also be underlying business and commercial differences, which could not be resolved through consultation. In the context of Stansted and the Commission's public interest finding, the CAA's decision on conditions is focussed on ensuring the processes, behaviours and information requirements for effective consultation are met.
7. The CAA has previously identified the Capital Investment Plan (CIP) as the appropriate vehicle for taking forward consultation on capital expenditure at the airport. The purpose of the CIP is to highlight current and future capital expenditure, provide explanation of how expenditure fits in with an overall development plan, and to link specific projects to overall development activities.
8. One of the major areas of disagreement between the parties has been the nature and scope of the STAL CIP and its relationship to a strategic business plan. In particular, the parties have disagreed on the degree to which sufficient explanation has been given to demonstrate how and why investments will be made and how specific projects relate to overall capital development.
9. To remedy the situation, the CAA requires Stansted Airport Limited (STAL) to conform to an information protocol. Against the background of the Commission's report, previous and current regulatory agreements on consultation at other airports, feedback from the parties, and discussions around consultation processes at other airports, the CAA believes there is a strong case for greater specificity on information exchange requirements between STAL and the SACC.
10. The CAA notes there are two levels of information required: an overall Strategic Business Plan, and a detailed list of the information that should be provided on individual projects. This information must link back to a robust business case justifying future capital expenditure.

11. The Strategic Business Plan is a document that outlines BAA's vision, strategic goals and provides options detailing how the operational outcomes that the airport wants to achieve for its customers and users will be achieved. The Strategic Business Plan will form the foundation for long-term and day-to-day operations as well as capital expenditure decisions. The Strategic Business Plan need not include specific commercial information such as board papers and internal operational plans. The CAA notes that there are currently documents used by airports and airlines that can usefully be drawn on to support the development of a Strategic Business Plan. These include:
- the land use plan;
 - the master development plan; and
 - the capital investment plan (CIP).
12. The CAA notes that while the STAL CIP has been a useful guide to the type of information that should be provided to airport users, there is a range of additional information that is not included in the CIP, such as the land use plan and master development plan, that should also be provided by the airport. This additional information could be provided through an augmented CIP or in a separate document, as determined by the parties.
13. The CAA will use compliance with this information protocol and the attitudes of the parties to information exchange during the consultation process itself (as evidenced through periodic reports from the independent facilitator) as evidence to judge the effectiveness of consultation by STAL.

Information to be provided in the Strategic Business Plan

14. The CAA expects STAL to provide detailed information to airlines to meet the requirements of the information protocol relating to the Strategic Business Plan. As noted above, the CAA envisages that while the annual CIP document provides the basic vehicle for disseminating this information, it must be supplemented with additional information not currently contained in the STAL CIP. This could be provided through an augmented CIP or a separate document, to be determined by the parties.
15. Regardless of the form documents take, the CAA expects the plan to contain the following elements:
- The principal drivers behind the airport's Strategic Business Plan: this includes any assumptions made by the airport regarding the future operating environment including desired levels of service and future constraints as well as the benefits to both users and the airport operator of future capital expenditure. It is not sufficient only to provide top line forecast data. It must include more specific information

around airport operations and capacities. It must include a degree of granularity such as the relationship of the development to peak and off-peak demand, be disaggregated across assets, and include information around choke points in airport operations.

- The forecast demand for airport outputs for the duration of the plan: this includes the level of demand for airport capacity and services as well as the factors that are likely to drive demand. Further, it should include detail to allow users to identify both the demand for particular facilities or services at the airport and information to demonstrate where capacity shortfalls might arise and where. This level of detail is important, as it will assist users to identify where there may be uncertainty or risk about future demand and to test the robustness of the plan. STAL should also identify the principal factors that are expected to drive different categories of the demand. In doing so, STAL should consult with airlines on options for facilities the airport intends to supply, and the extent to which the different parts of the infrastructure (e.g. passenger areas, stands, baggage systems, runways and airfield facilities) would meet demand forecasts under the different scenarios. This should provide users with a forecast of the extent to which the airport would be able to meet expected demand for outputs, and the implications of this for the quality of service that airlines receive at the airports. This analysis should also quantify other benefits to be delivered by the plan. As with consultation on options for airport development, the discussion on specific capacities to be provided should also encompass airlines' views on current and future operational processes, requirements and airline moves. This may involve discussions about airlines' future plans (e.g. for check-in, fleet, baggage).
- The capacity the airport intends to provide to meet demand: this includes the facilities the airport intends to supply and how these will meet forecast demand including a comparison of capacity and demand by airport facility. The airport should also identify how different levels of demand will impact on service quality.
- Options for development of the airport around the central scenario within the Strategic Business Plan: this includes details of cost, output trade-offs and where possible the impact on user charges, service quality and capacity associated with each option. It is not sufficient only to provide top line data. It must include more specific information such as a long-term land use plan, highlighting options for infrastructure to be delivered across the airport, and provide evidence that demonstrates how best to use the land in the future. Further, the impact on user charges cannot be withheld based on the argument that it is uncertain how price controls might be set or adjusted in future. Regardless of the price control approach the CAA adopts in future, the

indicative impact on user charges as a result of the development should be provided as well as the assumptions behind the calculation.

- The resourcing implications behind the Strategic Business Plan: this includes estimated total costs of the plan and pricing implications for users. This should state what major assumptions have been made, including timing of key projects and the expected costs and levels of any operational disruption. Consultation on the total cost of the investment plan for future price control periods will also encompass consultation on the appropriate level of risk that should be incorporated into the cost of the programme.
16. In addition, the Strategic Business Plan must include all assumptions made by STAL, with reasons, so that the airlines can understand the inherent risks and sensitivities involved.
 17. The plan should be built on detailed project specific information that should also be provided to airport users. The requirements for project specific information exchange are noted below.
 18. In order that both parties have a clear record of information that is shared, STAL should create a master 'document log' setting out what information is available to the airlines in both the Strategic Business Plan and on each project, and should offer to provide users all non-confidential, relevant project-specific information which it has in its possession (including, for example, where appropriate, consultants reports).
 19. As noted above, the Strategic Business Plan would complement and draw on, where relevant, material from the airport's Masterplan document. The timing of this latter document depends partly on Government airport policy consultations/decisions, and on the need to keep the overall vision for the airport up to date. Updates will also be necessary to deal with strategic aspects (such as scope and timing) of major developments left open in previous versions.
 20. Consultations on the airport's Strategic Business Plan and also on the necessity and scope of specific projects need to proceed in the confidence that the proposals are aligned with the overall airport Masterplan. It is for this reason the CAA envisages that the annual CIP document should be supported by a long-term land use plan, highlighting the infrastructure to be delivered across the airport campus by the investment proposals. The annual CIP document should also provide updated information on the long-term land use plan (at a level of granularity that permits informed discussion), which is likely to be relevant to airlines' consideration of the CIP. The long term land use plan will provide a view on how best to use the land well into the future, and from which the incremental infrastructure plans (next 5 to 10 years), both above and below the surface, can be considered and shown to align with the long term land use plan within the context of the current Masterplan.

21. Consultation on the long-term land use plan should also incorporate information on asset disposals. STAL should consult airlines before disposing of any of its land or buildings, whether through sale, partial sale, long lease or joint venture, including disposals from the airport company to other entities within its holding companies. Consultation information will include the timing of the proposed disposal, potential impact on both current airport operations and on future airport development, and measures taken to protect future airport development (e.g. proposed buy back options and their terms). The airport will also inform users and the CAA on any subsequent disposal of assets which were formerly within the scope of STAL and which had been transferred out of STAL during the Q5 price control period to another entity within STAL's holding companies. Where there may be reasonable doubt as to whether or not a particular asset does or does not fall within STAL's asset base, the airport will consult with airlines on its disposal in advance.
22. The CAA recognises that the plan published for consultation will be STAL's plan and will therefore reflect STAL's interpretation of elements listed above. The consultation that will follow publication will allow airlines the opportunity to interrogate these interpretations and offer alternate perspectives. Any outstanding differences between airport operator and airlines about the scope and depth of information provided as part of this consultation may be referred in the first instance to the appointed consultation facilitator.
23. The CAA recognises that some elements of the data contained within the Strategic Business Plan and/or its associated supporting documents may need to be covered by a confidentiality agreement (and/or disclosed in a restricted manner) to ensure that consultation does not prejudice commercial interests.

Information to be provided on specific projects

24. The CAA expects STAL to provide detailed project information as part of the consultation process with airlines. This disaggregation of more detailed information should state what major assumptions have been made, including the timing of key projects. The CAA would also expect STAL to provide detailed project information around the cost estimates of individual projects within the capital expenditure programme and the outputs that are expected from individual projects.

Projects covered

25. The CAA would expect all major projects to be included in detail and that the information should cover all projects making up the majority of the total forecast capital expenditure programme. The CAA would expect STAL to consult and to seek agreement with airlines at the outset of the Q5 period (and where necessary thereafter) on the definition of 'major projects' to be subject to the full information disclosure, and on the appropriate level of

information to be disclosed at each stage in the lifecycle of projects which extend over several years. Any outstanding differences between airport operator and airlines about the scope and depth of information provided as part of this consultation may be referred in the first instance to the appointed consultation facilitator.

Revenues/benefits

26. For each (major) project, the CAA would expect to see cost benefit analyses of the capital investment options for both STAL and the airline community (to the extent that STAL is able to estimate the costs to the airlines) and the steps taken to optimise the balance of costs and benefits. For any project, it should be clear how the benefits justify the costs.
27. For each (major) project, the CAA would expect to see STAL set out the benefits to STAL, the airlines and passengers, including:
- benefits that will be realised in terms of increased capacity, increased forecast passengers, improved service levels, statutory compliance etc (the outputs should be quantified wherever possible and provided on an incremental basis at a level of detail appropriate to the stage of the project);
 - operational improvements, which may involve discussions about future airline plans for check-in, fleet, baggage etc, and the level of flexibility to changes in forecasts;
 - the facilities which the airport intends to supply and the extent to which the different parts of the infrastructure (passenger areas, stands, baggage belts, runways and airfield facilities etc) will meet demand forecasts under the different scenarios. In the initial publication of a project in a CIP, and in advance of receiving airline feedback, the performance of a project will be demonstrated against the different scenarios anticipated by STAL; and
 - any commercial revenues which STAL anticipates the investment will generate, including not only commercial revenues accruing from the scheme but also a statement as to how much of this commercial revenue would be incremental, having regard to consequential impact on existing commercial income streams (recognising that income from new retail is not always additive). The CAA expects that STAL will share with the appropriate airlines and/or their representative bodies information on the commercial revenues it anticipates the investment will generate, except where STAL considers that disclosure of the information could jeopardise either its, or a third party's, commercial interests. The CAA recognises that this may require a limit on the number of consultees and that confidentiality agreements (or other restrictions) may be needed to ensure the security of the information.

The CAA expects STAL to make best endeavours to find practical means by which information can be both shared appropriately as necessary and given adequate protection from wider release, where this may be contrary to STAL's or other parties' commercial interests. The CAA also recognises that there may be cases where STAL does not consider it appropriate to release this information even with the above safeguards and in these instances the airport will explain why disclosure is not possible.

Costs

28. For each (major) project, the CAA would expect to see statements of need and design requirements (as appropriate) upon which the projects are based, as well as information on the procurement strategy for the project.
29. For each (major) project, the CAA would expect to see the costs to STAL, the airlines and passengers, including:
 - the effect on airport charges;
 - the profile of the annual capital costs;
 - updated and auditable information showing how expenditure incurred to date relates to the latest anticipated costs of the projects;
 - total capital expenditure (including the phasing) and the anticipated incremental impact upon the operating costs of STAL and (to the extent that STAL has such information at its disposal) the operating costs of airlines (subject to general restrictions on the disclosure by STAL of commercially confidential information);
 - an analysis of costs into base construction costs, risk allowances, on-costs and any other provisions such as site-specific costs;
 - an explanation of any positive or negative cost comparison with similar past projects and with external benchmarks; and
 - specific details of alternatives considered and analysis of reasons for choosing the preferred option.

Timing

30. In order to assist the users' understanding, information on the timing of (major) projects should be provided, to include:
 - the planned budget in current and future years (and associated supporting information) for the replacement of life-expired assets;

- the programme and project gateway approval dates, consistent with the projections of the timing of future capital expenditure provided in the CIP; and
 - information on anticipated asset lives associated with the development proposal.
31. The timing of consultation should be prior to STAL moving a (major) project from an outline description (exploration phase) to options development, which means that it would be prior to any option decision or construction design. In particular, the CAA expects STAL to begin consultation at the stage when a potential need for a project is identified, before solutions are considered, and that users should have a substantive input into the brief for any (major) project prior to consideration of options to meet an identified need. As noted above, the depth of information provided at each stage will need to reflect the point that each project has reached in its own lifecycle.
32. The CAA expects that consultation will be structured to support the key decision points in STAL's project process. For those major projects subject to individual consultation, STAL will ensure that airlines are consulted in a timely fashion at the following stages: (i) prior to STAL moving the project from brief description to options development, (ii) prior to option decision, and (iii) prior to construction design. The CAA expects that the airlines involved in this process would make best endeavours to ensure that their inputs to such consultation are timely and do not delay the overall timeliness of programme and project delivery. If airlines do not participate when invited and subsequently try to hold up or to reject the project proposals, the CAA recognises that STAL may need to proceed (and document the reasons why) without airline agreement, in order to protect delivery for the wider user benefit.
33. The CAA expects that consultation on the selected projects will, over time, encompass the progression of the design and delivery of the project. Consultation should also focus on the utilisation of the risk allowance factored into the project cost. STAL will provide reports to show how risk money has been used and airlines should be consulted in advance of any significant use of risk monies.

Relationship to Strategic Business Plan

34. The CAA would expect there to be an auditable reconciliation of the detail provided to the airlines on individual projects to the total proposed capital investment set out in the Strategic Business Plan.

Review

35. For completed/nearly completed (major) projects, there should be information on:

- lessons learned/stakeholder feedback on recently completed projects;
- out-turn performance of projects against the outputs anticipated in previous plans; and
- project evaluation, highlighting performance in terms of cost, infrastructure delivered and benefits realised (including, where relevant, operating cost efficiencies achieved and commercial revenue generated).

Change

36. Inevitably, projects will change during the course of each quinquennium. The CAA would expect information from STAL to provide adequate transparency on such changes. This information should include, for (major) projects:
- the rationale for any (material) changes, which should be discussed with airlines before decisions are taken; and
 - the implications of any (material) change, including on benefits, costs and operational activities.
37. Minor modifications to the plan may be excluded from this process of transparency and consultation, unless they have significant effects on the overall investment programme and/or operation and development of the airport.

Minor projects

38. The CAA expects that STAL and the airlines should agree between them the monetary level of annual cap on minor projects below which the airlines would not need to be consulted, at the same time as confirming the threshold for consultation on an individual project (currently £2 million). The CAA would expect to incorporate the agreed thresholds into an amended updated version of this consultation protocol. If the parties were unable to agree on the thresholds, then the CAA would determine the thresholds (both the annual cap and the threshold for consultation on an individual project), after consulting the parties and the facilitator.

Confidentiality

39. Some elements of the data provided by STAL may need to be covered by a confidentiality agreement (and/or disclosed in a restricted manner). In general the CAA would expect information to be shared, except where STAL considers that disclosure of the information could jeopardise either its, or a third party's, commercial interests. The CAA considers that the appointed facilitator could assist in this process.

40. For the sake of clarity, the following are examples of material, or circumstances, when STAL might not be able to provide information owing to confidentiality issues:
- information relating to projects required to support the introduction/commercial interests of a specific airline or service provider new to the airport;
 - information relating to commercially sensitive discussions around the disposal of an asset;
 - human resource projects or tender information; and
 - information relating to a public inquiry or legal challenge.

The consultation process

41. The Strategic Business Plan should form the basis of an effective consultation process, designed to provide airport facilities to best meet the current and future needs of airlines. Within this process, STAL should ensure that the material described above is provided to, and consulted with, airline users at the airport. The CAA expects STAL and its airlines to establish an appropriate consultative body (or appoint an existing body) to facilitate this process. In addition, as set out in the public interest condition in Annex C to the CAA's decision document on economic regulation of Stansted Airport, the CAA has required that STAL shall, to a reasonable extent, co-operate with any independent facilitator initially appointed by the CAA in the resolution of disputes and other matters relating to consultation on airport development. The purpose of the facilitator is to facilitate consultation between STAL and users.
42. The facilitator should, as need be, work closely with the consultative body to agree membership and terms of reference supporting a structure of consultation that ensures a logical sequence of information flow is followed, in order for the linkages between the different information requirements stated above to be understood by airline users.
43. An important part of the work of the facilitator, as need be, and the consultative body will be to track progress during the quinquennium, to review implementation issues, and to act as a consultative forum for any proposed changes to the plan, for example changes to the scope, timing, costs or benefits of a project.
44. Consultation should encompass the exchange of information and subsequent discussion between STAL and airlines with the objective of achieving agreement, where possible, within an appropriate timescale to enable the successful delivery of the plan. The CAA expects that STAL will develop a project plan that will show reasonable timescales for consultation,

commensurate with project complexity. The plan will show the timing of key decisions needed to maintain project programme in line with the CIP. The CAA expects all parties to endeavour to meet this timescale.

45. It is recognised that agreement may not always be achieved in the time available to progress the investments. With this in mind, it will be the responsibility of the facilitator and consultative body on a yearly basis to provide an agreed record of the agreements reached and those areas where there has been disagreement. This record of agreement/disagreement should also highlight the process undertaken to attempt to resolve any disputes.
46. The CAA expects STAL and the airlines to attempt to establish an effective basis for consultation. The CAA acknowledges, nevertheless, that there may be outstanding disagreements between the parties on the scope, timing and substance of the consultation process. In such a situation, the CAA expects STAL and the airlines to work with the appointed consultation facilitator to seek to resolve differences that impede effective consultation, and to establish a workable basis for future consultation.

Monitoring and compliance

47. The CAA expects the appointed consultation facilitator will report to the CAA quarterly on the progress of consultation at Stansted Airport and, within that, STAL's performance against the relevant public interest condition and this information protocol. The report would be available to both STAL and the SACC. In addition to quarterly reports, the facilitator will also be expected to report at other times as it considers appropriate, especially in the event of an unresolved disagreement.
48. In situations where there is ongoing disagreement between the parties, the CAA expects the consultation facilitator to provide a report, available to the CAA and to both parties, describing the consultation process, the issues of disagreement, and proposals for taking forward future consultation. Disagreement between the parties is not in itself necessarily evidence of a failure by the airport operator to consult effectively (as opposed to evidence of differing views). It is therefore unlikely the CAA would consider regulatory action unless evidence from the facilitated process indicated STAL or the airlines had not:
 - reasonably adhered to the minimum requirements of the information protocol; or
 - co-operated, to a reasonable extent, with any independent facilitator appointed by the CAA.
49. In either of the situations noted above, the CAA may consider regulatory action and this could take a number of forms including:

- a change to a more appropriate remedy where the CAA could review and if need be modification of the terms of the public interest condition itself or this information protocol during Q5;
- continuing to highlight that the CAA will incorporate this type of evidence into the development of the appropriate regulatory regime in Q6;
- issuing a notice under section 73 of the Airports Act requiring the provision of information to the CAA; and/or
- if after investigating a complaint, the imposition of a compliance order on STAL under section 48 of the Airports Act.

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Annex E. Statement of Standards and Rebates at Stansted Airport

Introduction

1. This is the statement of Standards and Rebates published by the CAA in accordance with a Standards of Service Condition for Stansted Airport Limited (STAL)⁸³. It takes effect on 1 April 2009.
2. The Standards of Service Conditions require performance against services specified by the CAA to be published monthly, through prominent displays in the terminal at Stansted. The relevant services are specified in paragraph 15

Overview

3. Unless modified by agreement between the airport and the Stansted Airline Operators' Committee (AOC) notified in writing and approved by the CAA; or by the CAA; the operator of Stansted airport shall pay rebates to "Relevant Parties" as set out in the remainder of this statement.

"Relevant Parties" for the purposes of this statement are airlines that have paid "Airport Charges" in the relevant month in respect of passenger services;

"Airport Charges" has the meaning assigned to it by section 36(1) of the Airports Act 1986. For the purpose of the rebates under this statement the relevant airport charges shall be calculated net of any discounts;

"Monthly Airport Charges PAX Services" is the Airport Charges in the relevant month in respect of passenger services.

"Monthly Rebate" is the aggregate monthly rebate in the relevant month;

"Monthly Rebate %" is the aggregate monthly percentage in the relevant month.

4. The Monthly Rebate shall be calculated across all the passenger services using the airport and the same rebates as a percentage of the relevant charges shall be paid to the Relevant Parties using the main passenger terminal at the airport.

Payment of Rebates

5. The airport operator shall pay rebates to the Relevant Parties on a monthly basis in the month following the month in which they accrue. The rebates

⁸³ Conditions as to rebates to be paid by Stansted Airport Limited to users where quality of service fails to meet service standards in accordance with section 46(2) of the Airports Act 1986.

shall be allocated to the relevant parties that used the terminal in the relevant month *pro rata* with the airport charges incurred for passenger services in that month.

6. In total the rebates for each relevant month shall be:

Monthly Rebate = Monthly Rebate % x Monthly Airport Charges Pax services

Calculation of The Percentage Rebate

7. For each relevant month j the Monthly Rebate % shall be calculated as follows:

$$\text{“Monthly Rebate}_j \text{ %”} = \sum \text{MIN}[p_i, (p_i \cdot x_{i,j} + se_i \cdot nse_{i,j})]$$

Where:

p_i	is the relevant maximum rebate percentage per month for each element i as determined in Table 9-1;
$x_{i,j}$	= 0 if monthly standard i in month j is met as defined in paragraph 8; or = 1 otherwise.
se_i	is the relevant rebate percentage per “serious event” for each element i as determined in Table 9-1; (This currently only has a value other than zero for “Central Search” and “Outbound Baggage”)
$nse_{i,j}$	= the number of serious events for the relevant element i occurring in month j

8. The monthly standard i in month j is met if:

- for elements other than pier service, departure lounge seat availability, cleanliness, way-finding and flight information:

$$s_{i,j} \geq \text{Standard}_i$$

- for pier service, departure lounge seat availability, cleanliness, way-finding and flight information:
 - For months j from April 2009 to March 2010, meeting the standard for each element shall be based on a rolling average of the elapsed months up to and including the relevant month such that element i will meet the standard in month j if:

$$\frac{\sum_{m=1}^{m=j} \pi_{j-m+1} S_{i,j-m+1}}{\sum_{m=1}^{m=j} \pi_{j-m+1}} \geq \text{Standard}_i$$

- For months j on or after April 2010, meeting the standard for each element shall be based on a rolling average of performance over the preceding 12 months such that element i shall meet the standard in month j if:

$$\frac{\sum_{m=1}^{m=12} \pi_{j-m+1} S_{i,j-m+1}}{\sum_{m=1}^{m=12} \pi_{j-m+1}} \geq \text{Standard}_i$$

In circumstances where: $(j-m+1) \leq 0$
the relevant subscript indicates a month in the preceding relevant year such that a value of 0 indicates March, a value of minus1 indicates February, ..., and minus 11 indicates April.

Where:

$S_{i,j}$	is the performance of element i in month j on the same measurement basis as defined for the relevant Standard _i ;
π_j	is the number of terminal passengers in month j;
Standard _i	is the relevant monthly standard as defined in Table 9-1;
j	is a counter for the month under consideration April=1, May =2 , ..., March=12; and
m	is a counter of the 12 months ending in month j, where m=1,2,...,12.

Measurement and Exclusions

9. More detail on the measurement of elements and exclusions (the limited circumstances when time will not be required to be counted towards the time when equipment is unavailable or when other standards are not met) is set out in Appendix:
10. The relevant elements of service for calculating “Monthly Rebate %” are identified in Table E-1.

“Element”	identifies the relevant element of service;
“Metric”	defines the basis of measurement for each relevant element; and

“Standard_i”

defines the standard applying for relevant
element i.

Table 9-1 Stansted Airport

Element	i	Metric	Relevant time over which performance counts for rebates ⁸⁴	Monthly Standard _i	Monthly percentage Rebate for each element p _i	Rebate per serious event se _i
Central search	1	Percentage of passengers in 15 minute time slices when the calculated average queuing time <10 minutes	Period agreed locally between airport and AOC	95%	4.55%	
		Percentage of passengers in 15 minute time slices when the calculated average queuing time ≤ 15 minutes		98%		
		Day when maximum calculated average queue length in any 15 minute time slice > 30 Minutes				
Outbound Baggage	2	% time available	Period agreed locally between airport and AOC	99%	0.70%	
		System unavailable >30 minutes ⁸⁵				
Departure lounge seat availability	3			3.5	0.07%	
Cleanliness	4	Moving average QSM score		4.00	0.35%	
Way-finding	5			4.10	0.14%	
Flight information	6			4.20	0.07%	
Passenger-sensitive equipment	7	% time available	Period agreed locally between airport and AOC	99.0%	0.14%	
Arrivals reclaim (baggage carousels)	8	% time available	Period agreed locally between airport and AOC	99.0%	0.28%	
Stands	9	% time available	Period agreed locally between airport and AOC	99.0%	0.14%	
Jetties	10	% time available	Period agreed locally between airport and AOC	99.0%	0.14%	
Pier service	11	Moving average % passengers pier served	(1) For 2009/10, period since and including April 2009: (2) For 2010/11 onwards, last 12 months.	95.0%	0.14%	
Fixed electrical ground power	12	% time available	Period agreed locally between airport and AOC	99.0%	0.14%	
Tracked transit system	13	% time at least one car available	Period agreed locally between airport and AOC	99.0%	0.14%	
Staff search	14	Times <10 minutes	Period agreed locally between airport and AOC	95.0%	No Rebate	
		Times ≤ 15 minutes		98.0%		
Control posts search	15	Times < 20 minutes	Period agreed locally between airport and AOC	95.0%	No Rebate	

⁸⁴ Where relevant, if STAL and the AOC fail to agree a period for a particular element, the default time period will be the periods specified in Appendix 1.

⁸⁵ NB Scheme will not direct rebate to particular operators affected; the rebate will accrue *pro rata* to each airline's payment of airport charges in the relevant month.

Central search

11. The metrics for central search shall be calculated as follows:

For each relevant month the relevant time over which performance counts for rebates shall be divided into “15 minute time slices” beginning xx:00, xx:15, xx:30 and xx:45 in the respective hour;

For each “15 minute time slice”

$$\text{“Calculated Average Queuing Time”} = \text{Num} / A$$

Where:

A⁸⁶ average number of passengers per minute leaving the queue in the relevant 15 minute time slice;

Num⁸⁷ is the average number of people in the queue in the relevant 15 minute time slice.

12. The percentage performance figures for 10 and 15 minutes respectively are calculated by:

- a) Identifying how many passengers in the relevant month were processed in a time slice where the measured queue time is less than (a) 10 minutes or (b) 15 minutes
- b) Adding these respective numbers to the number of passengers who were processed in other 15 minute time slices in the relevant month where the measured time is less than (a) 10 minutes or (b) 15 minutes; and
- c) Then dividing these figures by the total number of passengers passing through central Search in that month day and expressing percentages.

Availability

13. “Availability” of relevant facilities is defined for element i in month j as:

$$\text{Availability}_{ij} = 100 \cdot \left(1 - \frac{\sum_{k=1}^n TU_{k,j}}{n_i \cdot T_j} \right)$$

Where:

- Availability_{ij} is the percentage availability of element i in month j;
- n_i is the total number of assets included in element i;

⁸⁶ Calculated by measuring the exit numbers through the security arches every 60 seconds.

⁸⁷ Calculated by measuring the number of people in the queue every 60 seconds.

- k denotes a specific asset included in element i such that $k=1,2,\dots,n$
- $TU_{k,j}$ is the time that asset k is unavailable in month j in periods defined in Table 9-1 as modified by any relevant exclusions defined in 9;
- T_j is the total relevant time in month j as defined in Table 9-1.

Rounding

14. The reporting of all performance terms shall be reported to two places of decimals (in the case of percentages to 2 decimal places of a percentage point).

Publication of information

15. The airport will publish prominently in the terminal and on its public website, on a monthly basis, the performance against the standards with respect to:
 - Departure lounge seat availability,
 - Cleanliness,
 - Way-finding,
 - Flight information,
 - Central security queues,
 - Passenger sensitive equipment,
 - Pier service,
 - Arrivals reclaim (baggage carousels),
 - Tracked Transit System
 - Outbound baggage

Appendix to Statement on Service Quality Standards and Rebates

1. This appendix sets out the measurement methodology, contingency in measurement, exemptions (setting out the limited circumstances when time will not be required to be counted towards the time when equipment is unavailable or when other standards are not met), and relevant time over which performance counts for rebates, for each service element identified in the scheme.

General Principles

2. A monthly meeting will be held with the airlines, this currently being delegated to the AOC by the SACC, to agree the relevant planned maintenance system downtime for the following month and, once agreed, this downtime will be exempt from the measurement of system availability. This meeting will also include consultation on agreed planned downtime for major refurbishment or capital replacement of the relevant asset. Whenever possible, all maintenance activities will be planned to take place outside the peak operational periods unless agreed otherwise with the AOC.
3. A review meeting will also be convened with the AOC on a monthly basis to review all aspects of SQR performance and formally agree what performance measures have been met or failed. (This may be held as a separate meeting to that described in paragraph 2 or as an additional agenda item at the same meeting.)
4. All of the exemptions listed below are subject to passing one or more of the following processes of validation:
 - be sanctioned by a monthly meeting of the airport and representatives of the airlines delegated by the SACC, convened to agree the relevant planned maintenance system downtime for the following month and, once agreed, this downtime would be exempt from the measurement of system availability; or
 - be sanctioned by a monthly meeting of the airport and representatives of the airlines delegated by the SACC, convened to review all aspects of SQR performance and formally agree what performance measures have been met or failed; or
 - be sanctioned following some process of arbitration agreed by both the airport and airlines⁸⁸; or
 - where there is clear documentary evidence that an airline or its agents (e.g. handler) has admitted responsibility for a failure.

⁸⁸ It is not currently envisaged that this would be arbitration by the facilitator described in annex D although there may be a role for the facilitator in helping the parties agree such a process.

Data Collection Methodology

Security Queuing

5. The Central Search performance is measured by a system called 'Beacon', which collects data for the entire operational day. The current system measures a significant sample size of the whole operational performance. It measures 3 entry points that feed on to 6 x-rays, and uses cameras to capture the data. The methodology for measurements of security queuing time from queue size and exit rate analysis is as follows:

Data Sets

6. The data sets available for analysis are:

The size of the queue (taken every 60 seconds⁸⁹), and, the exit numbers through the security arches.

The calculation for queue times uses 'Little's Law' which states:

The average number of things in the system is the product of the average rate at which things leave the system and the average time each one spends in the system. (And if there is a gross 'flow balance' of things entering and leaving, the exit rate is also the *entry rate*.)

If T is the time (in minutes) spent in the queue; A is the rate of departure from the queue (in passengers per minute); and N is the average number of people in the queue.

$$\text{Then: } N = T A$$

As we will be measuring the exit rate (A) and the number of people in the queue (N) then:

$$T = N / A$$

For the purposes of the result data, the exit counts from the 'system' have been used.

7. The period of time over which this calculation is used has been set to 15 minutes⁹⁰.

⁸⁹ The frequency of the queue measurement is configurable, i.e. increased or decreased where appropriate.

⁹⁰ Too short a time means that the measurement can be affected by a low exit rate in this period (i.e. only 2 or 3 people exiting the system in a minute). Too long a time can hide potential slow periods within the time span (i.e. a very busy/slow exit 15 minute period within an otherwise slow hour).

Queue Specifics

8. In order to measure the queue time the precise formulation of the queue needs to be defined. This needs to be determined from a number of components:

Queue Start – The queue start position is defined as when the passenger enters the security bay area.

Queue End – The queue end position is defined as the point at which the passenger places their hand luggage onto the x-ray machine.

Queue Time Measurement

9. Single Bay – For a single bay the average queue time calculation is presented over a 15 minute period. It takes the average queue in that period and uses the exit rate from that period. This interpretation should be understood by the user, i.e. it is an average value for a specified period, it is not stating that in a specified 15 minute period all passengers queued for the stated time.
10. Multiple Bays – Where data is being recorded across multiple or the complete security bay area, the queues and exit rates are summed to provide a total figure for the bays⁹¹.

Queue Beyond Security Area

11. On the rare occasions when the queue extends beyond the Security Area, there are 3 options that can be employed. Predominately option 3 is the method used to both measure and review performance beyond the security area, however, on rare occasions option 1 may be employed. The options are:
- 1) A member of staff is deployed with a proforma and stopwatch. This staff member will capture the length of time a passenger, joining the end of the queue, and entering the area.
 - 2) A staff member will use the CCTV monitor at the back of Central Search which observes the queue, and will capture the same data.
 - 3) Staff in the Combined Control Centre will use their CCTV monitor to capture this data.
12. The percentage performance figure is calculated by:

⁹¹ Because the security bays are largely made up of separate queues in each bay, aggregating this information to provide a total may not be a true reflection of the maximum queue time for a specific period. One queue may be moving much slower than another (i.e. only one security arch operational) and hence this aspect of the queue performance will not be apparent in the aggregated data.

- (a) identifying how many passengers were processed in a time slice where the measured queue time exceeded 10 minutes;
 - (b) adding that to the number of passengers who were processed in other time slices where the measured time exceeded 10 minutes; and
 - (c) then dividing this figure by the total number of passengers passing through central Search in that operational day and expressing as a percentage.
13. All the data is fed and stored into the airports OPM system. The system is currently set up to capture 5 minute and 10 minute queues, but not 15 minute queues. The data for 15 minute queues will be captured in the database, and can be extracted when needed. To ensure it feeds directly into OPM there will be a level of investment required.
14. In the event of a security queue exceeding a 30 minutes queue time, then there is a single daily penalty. The measurement of this element will follow the above methodology that is within any relevant 15 minute time slice period, if the average over the six lanes exceeds 30 minutes, then a single serious event penalty would be triggered (subject to the maximum monthly rebate per month for central search).

Contingencies

15. If the automated measurement system 'fails', the data will be collected manually using the same process as detailed in the 'Queue beyond Security Area' above, but, covering the whole security area from the moment when a passenger joins the back of the queue (inside or outside the Security Area), to the point at which the passenger places their hand luggage onto the x-ray machine.

Exemptions

16. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- There is a severely disrupted operation due to increased security requirements. In these instances, National Security and public protection will be a priority.
 - There is a severely disrupted operation due to weather (e.g. flights re-directed or delayed due to fog / snow).
 - There is a severely disrupted operation due to an evacuation (e.g. a bomb scare resulting in passengers or vehicles being held).
 - Throughput is in excess of 10% above planned levels over a period of 1 hour or more. In the event that this occurs STAL will be required to

produce evidence to demonstrate that the operational assumptions for that day were reasonable.

- Industrial action by an airline or airline contractor that directly affects the Central Search operation.
- Failure of an airline's check in system, and resulting contingencies present passengers in a different reporting profile than planned for. The failure of the STAL network or power provision will not be exempt from this measure.
- The capacity of an airlines check in system cannot cope with the passenger demand, resulting in a different reporting profile than planned for.
- Any disruption to flow as a result of major public transport issues.

Operational Hours

17. The agreed operational hours for the purposes of measurement are from 0300 hrs to 2100hrs local.

Outbound Baggage System

18. Stansted has 4 check-in islands and the data collection is derived by analysis from the following systems:
 - Supervisory Control and Data Acquisition (SCADA)
 - Management Information System (MIS)
 - Elyo Database
19. The availability of islands 1, 2 and 3 is derived by analysis of the SCADA database.
20. Island 5 availability is calculated using the Elyo database. A week of data is interrogated on an Excel spreadsheet to identify possible downtime. If any non system downtime has been identified then that figure is manually calculated and added to the Excel spreadsheet and identical formulas used to produce total runtime of line per day, total downtime of line per day and final availability % of line per day.
21. A single event failure over 30 minutes on any of the check-in islands will generate a single serious event unless the Baggage Team Manager (BTM) offers the relevant airline's representatives an alternative check-in location (potentially utilising an alternative island) within 15 minutes of the reported

time of the system failure⁹². The single event data of reported time of fault and reported time of offer of alternative check-in facilities will be recorded by the BTM and a report manually produced utilising the data.

Contingencies

22. Each system failure or event which exceeds 4 minutes duration is captured manually by the BTM. In the event of a failure of the Elyo database system an average availability report will be produced utilising that data.

Exemptions

23. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- Any fault or stoppage that occurs as a result of a mis-loaded bag onto the system. A mis-loaded bag will be considered to be a bag which has been loaded in such a fashion as to have caused the system to stop.
 - Any fault or stoppage that occurs as a result of an unsuitable bag being loaded onto the system. An unsuitable bag will be considered to be a bag which is either an out of gauge bag or a bag with straps or handles that results in a system stoppage.
 - Any fault or stoppage as a result of any resource issue or industrial action taken by the baggage security screening contractors.
 - Any fault or stoppage as a result of malicious actions found to have been taken by an airline or airline contractor.
 - Any fault or stoppage as a result of an emergency stop activation, fire alarm, evacuation or suspect bag (level 5).
 - Any fault or stoppage as a result of insufficient airline check-in capacity leading to a baggage injection rate that exceeds the system's capabilities.
 - Any fault or stoppage as a result of airline resource issues within the baggage hall leading to chutes full and system dieback.
 - Any fault that has been observed by an airline or airline contractor and not subsequently reported to the Baggage Control Team.
 - Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.

⁹² It will be at the airline representatives' discretion whether they choose to utilise the alternative check-in facilities.

- Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

Operational Hours

24. The agreed operational hours for the purposes of measurement are from 0300 hrs to 2100hrs local.

Quality of Service Monitor (QSM) General description

25. This general description of QSM applies to the departure lounge seating, cleanliness, way-finding and flight information measures.
26. QSM data is collected as follows:
 - **Departing Passengers** are interviewed at the gate/gate area, immediately prior to boarding the aircraft. Interviewing in this location gives passengers the maximum opportunity to use services/facilities before they are interviewed. A typical departure interview takes around 5-6 minutes.
 - **Arriving Passengers** are interviewed on the Landside Arrivals Concourse just before leaving the terminal building. Again, this interview location gives passengers the maximum opportunity to use services/facilities before they are interviewed. A typical arrival interview takes around 2-3 minutes.

Passenger Selection for Interview

27. Selecting passengers to take part in the survey must be random and unbiased thus ensuring that every passenger has an equal opportunity to be interviewed. Interviewers follow a sampling ratio when selecting passengers within the gate room/area i.e. 1 in 10 or 1 in 15 passengers. This ratio is dictated by the conditions at the gate at the time of interview.
28. To be eligible for interview, passengers must be aged 18 or over.

When is Interviewing Conducted?

29. During the course of a month interviewing will be conducted on a selection of mornings/afternoons and weekday/weekend. A typical morning shift runs from 0700 -1400 hours and an afternoon shift runs from 1400 - 2100 hours. This ensures that changes in the airport environment and passenger profiles are represented.

How Many Passengers are Interviewed?

30. Because it is not possible to interview all passengers travelling through the airport a sample of passengers need to be selected for interview – this is referred to as a ‘quota’. The airport currently interviews approximately 11,000 passengers (departing and arriving interviews combined) per year at Stansted. In order to ensure that the interviews obtained over the year reflect the known profile of passengers travelling through the airport, passenger figures (from STAL’s traffic statistics database) are used to structure the quota. This quota is set by country of destination for departing interviews and country of origin for arriving interviews.
- 9.7 The QSM scores are calculated through a weighted average of the individual scores, weighted by actual traffic statistics for the month.

Contingencies

31. The data is collected by the QSM team using hand held PDA Systems. If the systems should fail, the team will revert to manually completing the questionnaires.

Exemptions

32. As data is captured over the month, it is unlikely that a single event will significantly affect the overall score. However, if it is felt that there may have been an impact, this will be discussed at the monthly ‘SQR’ review meeting described in paragraph 3 and any event that was outwith the control of STAL, and can be demonstrated to have had a negative impact upon the relevant QSM score, could be taken into consideration.

QSM Departure Lounge Seating

33. The average of the QSM scores for the single seat availability question:
- “Now, thinking about the departures lounge, how do you rate the ease of finding a seat?”

QSM Cleanliness (Departures: Toilets, Check in, Departure Lounge and Arrivals: Toilets, Landside Concourse)

34. The Cleanliness QSM measure to be used will be a weighted average of the QSM scores for cleanliness questions, weighted by the proportion of passengers using each type of facility

QSM Way-finding

35. Wayfinding is a combination of:
- Departures – Wayfinding – Within Terminals

- Arrivals – Ease of Finding Way Around

The results for these two questions are given an equal weighting, 50% each.

QSM Flight Information (Ease of Finding, Reading and Understanding)

36. Flight Information shall be a combination of:

- ‘Departures – Flight Information – Ease of Finding’
- ‘Departures – Flight Information – Ease of Reading’
- ‘Departures – Flight Information – Ease of Understanding’

with an equal weighting, 33.3% each.

Passenger Sensitive Equipment (PSE) – Lifts, Escalators and Passenger Conveyors

37. The data system used to collect and report upon the availability of lifts, escalators and passenger conveyors is MAXIMO.
38. A fault or downtime with any lift, escalator or passenger conveyor is normally recorded from one of two sources. If a fault is discovered as part of a planned inspection then the downtime is registered in MAXIMO using the time the fault was discovered as the start of the downtime. If the fault is reported by a third party via the fault reporting process then the time is registered in MAXIMO using the time the fault was reported as the start of the downtime.
39. The fault management team at the Business Support Centre then raise a work order for rectification of that fault and assign the work order to the relevant engineering or maintenance team. This may be directly employed technicians or contractors depending on the type of fault. The engineering or maintenance team then responds to the work order and repairs the fault. The work order is then closed in MAXIMO using the time the asset was returned to service as the up time.
40. The total asset downtime is the total time elapsed between out of service time and the back in service time registered in MAXIMO for that fault. The MAXIMO data is then verified and any spurious entries manually rectified and all work orders checked to ensure accurate and timely closure within the system.
41. The total asset downtime for each asset is then calculated on an accumulative basis for each individual asset then expressed as an overall asset availability figure for passenger sensitive equipment (PSE).

Contingency

42. In the event that the MAXIMO system is unavailable then the asset out of service time and back in service time is captured manually and the data is then processed in a similar manner as above.

Exemptions

43. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- Any downtime as a result of withdrawal of asset on safety or security grounds.
 - Any malicious act by a passenger, airline or airline contractor.
 - Any closure of passenger-sensitive equipment (lifts, escalators, moving walkways) in areas immediately adjacent to security queues where it is considered by the relevant airport managers that their continued use is likely to lead to unacceptable health and safety risks due to increased congestion.
 - Any closure of specific passenger-sensitive equipment adjacent to stands which are closed to ensure passenger safety during evacuation, emergency or safety incidents.
 - Any downtime where equipment is automatically shut down by fire alarm activation and the fire alarm activation is not due to a system fault with the fire alarm.
 - Any downtime due to the activation of an emergency stop button or break glass, limited to equipment where there is back indication of serviceability and limited to 10 minutes for each occurrence in the case of false alarms.
 - Any downtime to accommodate fire risk assessed deep cleans where an assessment of the equipment's condition has shown that a deep clean is needed to ensure a safe operation can be maintained and to reduce the risk of fire.
 - Any downtime to accommodate planned maintenance.
 - Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.
 - Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been

determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

Operational Hours

44. The agreed operational hours for the purposes of measurement are from 0300 hrs to 2359hrs local.

Arrival Baggage System

45. The availability for the arrivals baggage system is gathered and produced monthly using the Elyo database. The data is exported to an Excel spreadsheet and filtered to display every fault or event for each day. Total downtime for each fault or event is highlighted and the data then transferred to a similar spreadsheet to that used to calculate outbound baggage system availability for islands 1, 2, 3 and 5. Following application of the formulae within the spreadsheets, the figure is derived for reclaim lines runtime, downtime and % availability.

Contingencies

46. Each system failure or event which exceeds 4 minutes duration is captured manually by the BTM. In the event of a failure of the Elyo database system an average availability report will be produced utilising that data.

Exemptions

47. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- Any fault or stoppage that occurs as a result of a mis-loaded bag onto the system.
 - A mis-loaded bag will be considered to be a bag which has been loaded in such a fashion as to have caused the system to stop.
 - Any fault or stoppage that occurs as a result of an unsuitable bag being loaded onto the system. An unsuitable bag will be considered to be a bag which is either an out-of-gauge bag or a bag with straps or handles that results in a system stoppage.
 - Any fault or stoppage as a result of malicious actions by an airline or airline contractor.
 - Any fault or stoppage as a result of an emergency stop activation, fire alarm or evacuation.
 - Any fault or stoppage as a result of baggage loading that exceeds the

system's design capabilities.

- Any downtime to accommodate planned maintenance.
- Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.
- Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.
- Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

Operational Hours

48. The agreed operational hours for the purposes of measurement are from 0700 hrs to 2359hrs local.

Stand Availability

49. Data is recorded in an operational system called AOMIS by the Airside Operations stand planning team. This team record and edit the live information in AOMIS including daily restrictions and stand availability. The system only retains the information for 10 days so the data is reviewed each week and transferred to PDF format. Each month the PDF data is manually compiled onto an Excel spreadsheet and a verification process applied to the data to ensure no incomplete information or duplication exists.
50. Within the spreadsheet the total hours of non-availability are calculated over the month by summing up each record that meets the stand asset availability criteria. A list of stands is also totalled within the spreadsheet and multiplied by 24 hours and the number of days in the month to give a total number of hours available over the month. A calculation then derives the percentage of time all measured stands are not available against the total time they are available and by deducting that from 100, a percentage figure of availability is made available.

Contingencies

51. In the event that the AOMIS system is unavailable then the data is captured manually by the Airside Operations team and is used in a similar manner as above for the calculation of the stand availability figures.

Exemptions

52. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.

- Northside stands.
- Cargo stands.
- Centre MARS stands.
- Southside remote stands not generally used for passengers flights (D76 and Compass Base).
- Stands not available due to faulty or abandoned equipment belonging to an airline or an airline contractor.
- Stands not available due to a malicious act by an airline or an airline contractor.
- Stands taken out of service to accommodate high security flights.
- Stands closed to ensure passenger safety during evacuation, emergency or safety incidents.
- To accommodate annual and five yearly statutory inspections, where this work is done in consultation with the AOC, and the period specified in advance, the exclusion not to be more than two days over any year (measured from 1 April –31 March) for any particular relevant asset. If works extend beyond any notified period, then any additional downtime would count against the serviceability standard.
- Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

Operational Hours

53. The agreed operational hours for the purposes of measurement will be over a 24 hour period.

Jetty Availability

54. The data system used to collect and report upon the availability of jetties is MAXIMO. A fault or downtime with any jetty is recorded from one of two sources. If a fault is discovered as part of a planned inspection then the downtime is registered in MAXIMO using the time the fault was discovered as the

start of the downtime. If the fault is reported by a third party via the fault reporting process then the time is registered in MAXIMO using the time the fault was reported as the start of the downtime.

55. The fault management team at the Business Support Centre then raise a work order for rectification of that fault and assign the work order to the relevant engineering or maintenance team. The engineering or maintenance team then responds to the work order and repairs the fault or resets the jetty limits if the cause was user error. The work order is then closed in MAXIMO using the time the asset was returned to service as the up time.
56. The total asset downtime is the total time elapsed between out of service time and the back in service time registered in MAXIMO for that fault. The MAXIMO data is then verified and any spurious entries manually rectified and all work orders checked to ensure accurate and timely closure within the system. The total asset downtime for each asset is then calculated on an accumulative basis for each individual asset then expressed as an overall asset availability figure for jetties.

Contingency

57. In the event that the MAXIMO system is unavailable then the asset out of service time and back in service time is captured manually and the data is then processed in a similar manner as above.

Exemptions

58. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption:
 - Jetty downtime as a result of user error.
 - Jetty downtime as a result of a malicious act by an airline or airline contractor.
 - Jetty downtime as a result of user error resulting in longer term fault.
 - to accommodate annual and five yearly statutory inspections, where this work is done in consultation with the AOC, and the period specified in advance, the exclusion not to be more than two days over any year (measured from 1 April –31 March) for any particular relevant asset. If works extend beyond any notified period, then any additional downtime would count against the serviceability standard.
 - Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.
 - Any downtime when equipment has been taken out of service whilst a

major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

- A jetty will be considered to be in service in the event that the corresponding stand is out of service.

Operational Hours

59. The agreed operational hours for the purposes of measurement are from 0600 hrs to 2359hrs local.

Pier Service

60. Flight data records and passenger loads are verified by the Business Support Centre prior to them being released into the BOSS Airport Database (ADB). The data is extracted from the ADB using varied reports then copied and pasted into Microsoft Excel. In Excel the data is managed to produce a detailed report of all flights not meeting the criteria for Pier Service. Individual flights that meet the basic criteria are analysed against operational records to determine if they should be included or whether they come under the exemptions.
61. The total numbers of passengers for each arrival or departure that meet the criteria for the Pier Service report are added up and expressed as a percentage of the total number of passengers on all Southside stands over the month.

Contingencies

62. In the event that the BOSS system is unavailable then the movement data is captured manually from the AOMIS system by the Airside Operations team and an estimate of passenger figures would be provided by the BSC for calculation in a similar manner as above for the production of the pier service figures.

Exemptions

63. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- Northside movements.
 - Flights that are parked on a remote stand following a request from either the handling agent or airline.
 - Repatriation Flights.

- Flights that are scheduled domestic in and international out or vice versa that we cannot accommodate on a mixed mode stand. All reasonable steps will be taken to prioritise these movements parking on the mixed mode stands.
- Flights that are domestic or international and are parked on a stand that requires passengers to be coached following a request from either the handling agent or airline.
- Flights that depart from non contact stands following a request from either the handling agent or airline.
- Diverted flights.
- Flights that depart from remote stands following a late aircraft change.
- Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.
- A stand will be considered to be in service in the event that either the jetty or FEGP is out of service.

Operational Hours

64. The agreed operational hours for the purposes of measurement are from 0600 hrs to 2359hrs local.

Fixed electrical ground power (FEGP) availability

65. The data system used to collect and report upon the availability of FEGP is MAXIMO. A fault or downtime with any FEGP is normally recorded from one of two sources. If a fault is discovered as part of a planned inspection then the downtime is registered in MAXIMO using the time the fault was discovered as the start of the downtime. If the fault is reported by a third party via the fault reporting process then the time is registered in MAXIMO using the time the fault was reported as the start of the downtime.
66. The fault management team at the Business Support Centre then raise a work order for rectification of that fault and assign the work order to the relevant engineering or maintenance team. This may be directly employed technicians or contractors depending on the type of fault. The engineering or maintenance team then responds to the work order and repairs the fault.
67. The work order is then closed in MAXIMO using the time the asset was returned to service as the up time. The total asset downtime is the total time

elapsed between out of service time and the back in service time registered in MAXIMO for that fault. The MAXIMO data is then verified and any spurious entries manually rectified and all work orders checked to ensure accurate and timely closure within the system. The total asset downtime for each asset is then calculated on a cumulative basis for each individual asset then expressed as an overall asset availability figure for FEGP.

Contingency

68. In the event that the MAXIMO system is unavailable then the asset 'out of service' time and 'back in service' times are captured manually and the data are then processed in a similar manner as above.

Exemptions

69. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.

- Any downtime as a result of user error.
- Any downtime as a result of a malicious act by an airline or airline contractor.
- FEGP will be considered to be serviceable in the event that the corresponding stand is out of service.
- System not used due to aircraft fault.
- System not used due to Handling Agent.
- Cargo stands FEGP.
- Any downtime to accommodate annual and five yearly statutory inspections, where this work is done in consultation with the AOC, and the period specified in advance, the exclusion not to be more than two days over any year (measured from 1 April –31 March) for any particular relevant asset. If works extend beyond any notified period, then any additional downtime would count against the serviceability standard.
- Any recorded downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working.
- Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity, where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional

downtime will count against the serviceability target.

Operational Hours

70. The agreed operational hours for the purposes of measurement is over a 24 hour period.

TTS – Track Transit System

71. System 'out of service' data, 'back in service' data or 'system on hold' data are recorded manually in the TTS Technicians log book and the Combined Control Centre Operator's log book. These data are collated on a monthly basis by the technician team and verified where possible against the system alarm log. The data are then manipulated to produce the average availability of the TTS in single car mode.

Contingencies

72. There is no contingency arrangement should the existing manual system of measurement fail although a robust contingency plan is in place which utilises coaches to transfer both arriving and departing passengers in the event that the TTS is unavailable.

Exemptions

73. Subject to the validation process set out in paragraph 4 the following situations could be eligible for an exemption.
- System downtime as a result of an emergency stop activation, fire alarm or evacuation.
 - System downtime as a result of weather.
 - System shutdown as a result of a malicious act by a passenger, airline or airline contractor.
 - Any downtime when equipment has been taken out of service whilst a major investment project or re-lifing is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target.

Operational Hours

74. The agreed operational hours for the purposes of measurement are from 0400 hrs to 2359hrs local.

Staff Search

75. There is currently no manual or automatic system in place to measure performance within this area. Following discussion with the ACC it has been agreed that we will continue to monitor the perceived performance within this area and will review our joint position on both the perceived level of service performance and the importance of this measure on an annual basis.

Control Post Search

76. There is currently no manual or automatic system in place to measure performance within this area. Following discussion with the ACC it has been agreed that we will continue to monitor the perceived performance within this area and will review our joint position on both the perceived level of service performance and the importance of this measure on an annual basis.