

## **Market Inquiry into the supply of airport services by BAA within the UK**

### **Submission by Stop Stansted Expansion ('SSE') to the Competition Commission ('the Commission')**

#### **1 Introduction**

- 1.1 SSE was formed in August 2002 and now has some 6,500 members including over 130 local parish councils, residents' groups and other organisations. Whilst our primary focus relates to Stansted Airport, SSE is also concerned with the broader implications of airport regulation as it applies throughout the UK.
- 1.2 Our submission draws upon documents which we have submitted to the CAA, the OFT and the DfT over the past year or so. Rather than repeat these texts verbatim in this response we consider that at this stage it would be more helpful to the Commission for us to identify the principal issues we regard as relevant, and to refer the Commission to those sections or paragraphs in the documents we are attaching, viz:
  - Attachment A: SSE response to CAA dated 17 March 2006;
  - Attachment B: SSE response to OFT dated 18 August 2006;
  - Attachment C: SSE response to DfT dated 18 April 2007.

#### **2 Summary of SSE's submissions to the Commission**

- 2.1 BAA's current market dominance in the south east, and the complex and bureaucratic system of regulation to which BAA is subject inhibits competition and choice. More efficient use of capacity would be achieved if there were to be effective competition such that the market was able to function as markets should – by setting prices and allocating resources to achieve the optimum balance between supply and demand. If competition in the sector is to be encouraged, ownership of both Gatwick and Stansted needs to be separated from ownership of Heathrow. The current under-pricing of London's airports also needs to be addressed so as to achieve more efficient allocation of resources and so that regional airports would be in a better position to compete with London's airports. Separation of ownership would have the additional advantage of finally bringing an end to the debate about cross-subsidisation between BAA's London airports.
- 2.2 These issues are considered further below under the following headings:
  - Current inadequacies in the present economic regulation of BAA;
  - Current inadequacies in the regulatory powers available to the CAA;
  - Cross-subsidisation between London airports;
  - Efficient use of airport capacity/investment;
  - Forced divestiture; and
  - Miscellaneous other matters.

### **3 Current inadequacies in the present economic regulation of BAA**

- 3.1 The complex and highly bureaucratic system of regulation currently applicable to BAA's London airports is not an effective proxy for competition as was intended when the regulatory framework was established by the 1986 Airports Act. As a result – in no small measure because it is able to 'game the system' – BAA has been able to benefit commercially at the expense of its competitors and customers. Particular examples of deficiencies exist in relation to:
- BAA's permitted cost of capital;
  - BAA's property transactions and on-site airport hotels;
  - Allocation of BAA central costs and revenues;
  - Treatment of BAA's World Duty Free business; and
  - Phasing of capital expenditure, efficiency savings and traffic growth over the quinquennial term.
- 3.2 The above issues emerge from our reading of the submissions made by BAA's airline customers to the CAA during the course of the current ('Q5') and previous quinquennial reviews. We assume that these same airline parties will elaborate upon these issues and provide relevant supporting evidence in their submissions to the Commission. [Attachment A, paras 73-82 and Attachment B, paras 1.3 to 1.5.]

### **4 Current inadequacies in the regulatory powers available to the CAA**

- 4.1 Section 41 of the 1986 Airports Act empowers the CAA to impose sanctions when it determines that an airport operator is charging below cost and thereby harming the business of another airport operator. In 1993 the CAA concluded, following a complaint from Luton Airport, that net airport prices at Stansted were below cost and were, in consequence, causing Luton material harm; despite its finding in favour of Luton, the CAA was unable to propose any remedy to ameliorate the position. In the SSE's view this example clearly demonstrates that Section 41 constitutes an impotent regulatory control.
- 4.2 More generally, the OFT has identified (para 3.28, Decision Document) a number of respects in which the CAA's powers are more limited than those of other economic regulators in the UK; it also notes (para 5.98 et seq), in relation to BAA's London airports, evidence of relatively high levels of profitability per passenger, and relatively poor performance of BAA in the quality of service to its customers and consumers.
- 4.3 We draw attention to the many concerns expressed to the Commission about BAA's market conduct in previous quinquennial reviews. For example, in the Q4 review, the Commission enumerated in its Report in excess of 100 complaints by airlines and service providers about the treatment they had received at the hands of BAA. Whilst the present inquiry is directed at structural, rather than behavioural, issues, in SSE's view there is overwhelming evidence available to demonstrate that BAA has 'gamed the system' to its own advantage, and, as the incumbent monopolist, has acted in an arrogant and high-handed manner in its dealings with airlines, competitors, suppliers and towards airport users generally.
- 4.4 The disclosure by the OFT that BAA, having 'opined' that it was 'incumbent' upon the OFT to include airlines within the scope of the present reference on the basis that they had prevented, restricted or distorted competition at BAA airports and then not to have produced any evidence to this effect (para 8.29, Decision Document), provides a further example of BAA's generally high-handed attitude (which SSE has itself experienced in its dealings with BAA). [Attachment A, paras 86 and 88-93 and Attachment B, paras 4.4 to 4.7.]

## **5 Cross-subsidisation between London airports**

- 5.1 As the OFT's Decision Document makes clear (para 5.87), BAA has not dropped its long-held view that it should be entitled to make up for any loss-making investment at Stansted by means of the imposition of higher charges at Heathrow and Gatwick. In SSE's view, past cross-subsidisation has distorted the market and has acted to the detriment of independently owned airports such as Luton; for this reason alone, SSE supports the OFT's view (ibid) that cross-subsidisation, in the event of over-investment at Stansted, 'would not appear beneficial for wider stakeholders' were it to occur. SSE considers that no such cross-subsidisation should be permitted. [Attachment A, paras 22, 69-72 and 89, Attachment B, paras 3.7 and 5.10 and Attachment C, paras 2 and 3.]

## **6 Efficient use of airport capacity/investment**

- 6.1 SSE submits that, for the reasons identified by the OFT (Decision Document, para 5.19), the present regime governing the regulation of BAA has a materially adverse effect on investment incentives. We consider that whilst competition in the south east of England would not in itself provide a greater incentive to invest in new capacity, increased competition would result in more efficient use of capacity, and investment would be more focused on delivering capacity where and when it is demanded and justified by the market. In SSE's view, BAA's ownership of the main London airports has resulted in less timely and cost-effective delivery of additional airport capacity in the south east. [Attachment A, paras 6-33, Attachment B, para 6.3 and Attachment C, paras 13-15.]

## **7 Forced divestiture**

- 7.1 The decision at the time of BAA's privatisation in 1987 to retain Heathrow, Gatwick and Stansted under common ownership has significantly failed to provide sufficient competition appropriate to the needs of airlines passengers and ancillary suppliers. In addition it has created unfair market conditions for BAA's competitors. In the circumstances we consider that the only solution to the present inadequate and unsatisfactory position (including the need to bring an end to the debate about cross-subsidisation between BAA's London airports) is to require separation of ownership. [Attachment A, paras 75 and 86-87, Attachment B, paras 5.2, 5.6, 5.10, 7.2 and Attachment C paras 12-15.]

## **8 Miscellaneous other matters**

- 8.1 The OFT leaves open the issue of whether or not Southampton Airport should be excluded from the geographic scope of the reference to the Commission (Decision Document, paras 4.5, 5.1). SSE supports the view of a number of airlines (ibid, para 4.59) that Southampton Airport should be included within the scope of the reference. [Attachment B, para 3.8.]

