

Summary of hearing with Ryanair 11 June 2008

Background

1. Ryanair's short-term financial position was 'dire', with a drop in profits from £480 million last year to break-even point if traffic grew by 5 per cent. Ryanair anticipated a number of bankruptcies across the industry with oil at \$130/barrel. Almost every airline across the UK, if not the rest of Europe, would lose money. Over the medium term, the outlook was difficult, but prospects were better outside the UK market. Ryanair expected it would place extra capacity outside the London market, because there was little spare capacity remaining within it. Additionally, the UK regional airports were becoming more competitive, partly as a result of BA withdrawing capacity, and partly because some airlines might go bankrupt. Ryanair had recently announced bases in Birmingham, Belfast, Edinburgh and Bournemouth. There was also some spare capacity at Stansted. Ryanair had grounded seven aircraft there last winter, but had restored it for the summer period.
2. [REDACTED]

Airport competition

3. [REDACTED] Ryanair could not move to Luton as Luton had no spare capacity. Were it able to do so, the costs at Stansted would probably be reduced. Ryanair would also consider Gatwick, but not Heathrow, and had been in discussions with Herne in Kent, though the runway was too short, and with Northolt, though this airport did not welcome civilian traffic despite its huge runway. As long as there was a connection to the centre of London, Ryanair would be happy to use any of those airports, and would move its operations to wherever capacity was cheapest.
4. The airline had evaluated these options in May 2007 when the Stansted discounts were withdrawn. [REDACTED] It had reduced capacity by 15 to 20 per cent over the winter, despite the possibility of losing the slots. For BAA, the decision to end the discounts had been simple, as a 100 per cent increase in prices had only caused a 5 per cent loss in traffic. EMA was not an alternative to serve the London market, even for Ryanair. Ryanair had written to Stansted asking for a discount this winter, though without much hope of success. It dealt less with Stansted management than with BAA head office. It did not appear that Stansted management had much discretion to agree discounts.
5. Ryanair would not be able to serve London from East Midlands Airport (EMA) even if EMA paid Ryanair £10/passenger. There was plenty of capacity there, and Ryanair would have transferred its London operation there when the discounts were ended at Stansted, had that been possible. Even if BAA increased its prices to £12.50 at Stansted, Ryanair would have no choice but to pay it, as it had paid the increase in charges in 2007, but would not grow its operation at Stansted, as was the case over the past year. It would attempt to recoup this increase through increasing passenger yields. Ryanair's long-term strategy for Stansted would be to build a new runway and terminal there for around £500 million, either funding this itself or guaranteeing to deliver another 20 million passengers. It had offered these terms to BAA.
6. [REDACTED]

7. On separate ownership, selling only one of the London airports would do little, but divestment of Gatwick and Stansted as well would incentivize the managements of the three separate companies owning the London airports to ask how capacity could be increased at each of them, both from existing assets and from new construction. Gatwick and Stansted were far from full at non-peak times, but there was currently no incentive for them to price lower at non-peak times. Ryanair would be very interested in using the off-peak capacity with flights from its 25 other bases around the UK and Continental Europe.
8. If BAA had excess capacity, it would be likely to discount additional traffic heavily, to incentivize future growth. BAA had been clever in unwinding its discounts in 2007, pricing massively up to the cap for the last year of the quinquennium, thereby funding the discounts it had given in the previous years. If BAA built its new capacity at Stansted, some new entrants might compete against Ryanair, but BAA would receive much of its costs back from existing users. BAA had been skilful at playing the regulatory regime to date, having benefited from a regulator which would rubber-stamp whatever they wanted to build.

Capacity expansion

9. The SG1 and SG2 projects should not be allowed to continue without user agreement. Ryanair supported a second runway and terminal at Stansted and where it had dedicated low-cost facilities overseas, these overseas contracts generally said that any other airline wishing to offer similar traffic growth to Ryanair must be given the same cost base as Ryanair. One example of this approach was at Bremen, where Ryanair had converted a large cargo hangar into a very simple passenger terminal. Birmingham had asked Ryanair to fill an empty terminal vacated by BA. Hahn, a former military airbase had built a simple terminal, obtaining funding after receiving Ryanair's guarantee to deliver traffic. Ryanair had designed a modular terminal at Stansted and Dublin. The Dublin terminal was costed at €140 million for a capacity of 25 million, and might be built at Stansted for £150 million to £200 million. It was fully specified and complete. Ryanair was not discussing this with BAA, though it would expect to do so in a normal commercial environment.
10. [X] The extra capacity in the second terminal would reduce charges in the existing terminal. The difference in operating costs between the terminals would be very marginal. Ryanair was not designing new terminals with big check-in areas because check-in was disappearing.
11. [X] If Ryanair funded the construction of a second terminal and runway at Stansted, it could either own and operate the terminal, or it could recoup its outlay through discounted charges. It agreed to provide the CC a summary of the models it used for financing terminal construction.
12. It had no examples of switching between terminals owned separately at the same airport, though at Tampere and Bremen it had switched within an airport. At Glasgow Prestwick it had switched to a competing nearby airport with more basic facilities. At Stansted, Ryanair would be able to move part or all of its operation to any new terminal it built, causing BAA to reduce its terminal charges in the original terminal. Unfilled capacity at the old terminal might cause BAA to offer other airlines massive discounts for remaining in T1 to 'teach Ryanair a lesson'.
13. The timing of the planning inquiry if Ryanair were to build the second terminal was unclear, though it might be shorter than the current inquiry because Ryanair's proposed terminal design required less greenfield land, and because the Stansted airlines would withdraw their objections in the planning process. Though BAA owned

the land, this would not be an issue if user requirements were the basis of the regulatory approach, since BAA would have an incentive to meet those requirements. There was no difficulty in a regulatory regime which required BAA to hand over land for a competing terminal.

Assets in operation and pre-approval

14. Assets should only enter the RAB when they came into operation. Ryanair was not concerned about any sudden increase in prices at that time. Ryanair's proposed new terminal would in any case reduce airport charges overall. The core issue was what was being built, rather than how the process allocated the cost. The cost increase would be further reduced if a new runway was constructed, because Ryanair would base more aircraft at Stansted from its opening.

SG1

15. Many of the SG1 projects were either entirely unnecessary for the expansion in capacity, or necessary, but gold-plated. The airlines had opposed increasing the planning limit for Stansted beyond 30 million passengers because this limit would prevent BAA from building further unnecessary facilities. It was possible that some proposed facilities could prejudice the most efficient layout for SG2. Ryanair had sent comments to BAA though its comments had not been adopted in the past. If Stansted were competing with other London airports, most of the SG1 capital expenditure would be removed from the plan. In a competitive environment, almost no capital expenditure would be required to increase the terminal capacity to 35 million. Most BAA proposals for SG1 were based on terminal constraints which were almost entirely notional.

Pre-approval

16. Requiring BAA to obtain airlines' approval before it was included in the RAB was strongly supported by Ryanair. SG1 was a distraction from what was required at Stansted, namely a simple second terminal and runway. Nothing besides another rapid exit taxiway was required to serve 35 million passengers. All the short-haul airlines were moving away from check-in desks, kiosks and baggage halls. Ryanair did not understand the terminal capacity constraint, which appeared to be a figure generated by the airport to justify unnecessary spending on additional facilities that do not increase capacity but only add to costs. It was also not clear why BAA did not incentivize off-peak travel, unless it was to argue for more capacity caused by peak bottlenecks. At the moment, Ryanair had little bargaining power with BAA because BAA could ask the regulator to fund a lavish new terminal and runway at Stansted through higher airport charges and historically the regulator had granted such increases.
17. Users should not have to fund an asset unless it was actually built. The second runway and terminal should only enter the RAB when operational. BAA had massively underspent on capital expenditure over Q4, though the traffic was significantly higher than forecast. It would be appropriate for this underspend to be removed from the RAB. The critical point was that over 75 per cent of the expenditure on SG1 was irrelevant and excessive, and should not therefore enter the RAB. The ACC was working on triggers, and would provide more information on what was required in SG1 and what was wanted in Q5.

Scotland

18. [X]

Consultation

19. Ryanair's responses to Capital Investment Plans (CIPs) in previous years had been completely ignored by BAA. It had been led to believe that there was a business plan which lay behind the CIP. There appeared to be a fixed view at BAA as to what the next 30 years should look like, with sequential runway developments at Stansted, Heathrow and perhaps Gatwick, and this plan might drive the traffic forecasts. Any competitive business would show a business plan to its customers at the start of an expansion project. Under the regulated system, however, the airport was not incentivized to do this, but rather to incur as much capital expenditure as possible. Ryanair was therefore informed what would be in the capital expenditure plan, and this expenditure was then funded through regulated charges. BAA had said that it considered the CIP to be its business plan. Ryanair did not believe, however, that the CIP would suffice as a business plan for a £10 billion corporation.

Traffic forecasts

20. Ryanair was quite confident that York Aviation's (York) forecasts would be reliable because York had been investigating the market in some detail, rather than relying on spill from Heathrow which, in a nutshell, was BAA's model. Despite significant increases in the assumed price of oil, airport charges and other variables, BAA's forecasts were always within one or two million passengers of the same number by 2015. It considered that BAA's passenger forecasts were numbers invented to justify its capital expenditure programme. BAA's central assumption of spill from Heathrow and Gatwick to Stansted had never materialized. Some of the long-haul carriers at Stansted, which had gone bankrupt, might have preferred to operate from Heathrow, but this impact was small. The last two remaining trans-Atlantic carriers, one of which was American Airlines, had both pulled out of Stansted.

21. [X] In a recession, some customers would no longer fly at the bottom end, while others would trade down from short-haul British Airways flights. This had happened in the last several downturns.

Facilities

22. The tracked transit system should be closed down as quickly as possible. It cost around £1 million/week. Passengers would willingly walk. It was very difficult for Ryanair to analyse BAA's cost structure because it never shared opex information. In the airline's view air bridges had a large operating cost and were completely unnecessary; security, if outsourced, would be significantly cheaper; and the new EU regulation on disabled passengers had increased the per passenger cost. If security were outsourced, however, BAA should not be involved in the tender because it could manipulate it. Instead the airlines should run the process, through the ACC. Security standards had improved recently, but only because of winter. BAA's security provision at Stansted was 10 or 12 months behind in terms of the adoption of new procedures. At the Scottish airports, however, BAA's security was satisfactory. Ryanair had experience of dealing with industrial relations as it employed 6,000 people including pilots.

Non-regulated charges

23. The airline did not have a strong view on the split between regulated and non-regulated charges, though it did not fundamentally disagree with the single till. For 12 years, BAA had over-recovered its fuel levy. It should not be permitted to move these costs now into the RAB and to continue to over recover on these costs. It was likely that BAA could do better on commercial revenues, though these were not significant compared to runway and terminal charges. At Stansted, Endeavour House, which was built 20 years previously, was still empty. There appeared to be no attempt to market it. In an effective regulatory environment, or a commercial environment, BAA would have stronger incentives to increase commercial revenues because its aeronautical revenues would be limited to recovering costs. BAA might be allowed to keep all commercial revenues in the future if low-cost runways and low-cost terminals were built.
24. Prestwick was a good example of an airport which delivered what Ryanair wanted, which was quick turnarounds and no delays. If fares were low enough, passengers would tolerate almost any experience as long it was safe and on time.

Wrap-up

25. The space on Ryanair aircraft freed by moving away from checking-in baggage would remain empty, and Ryanair would therefore be able to fly lighter planes. It would also allow airports to be much simpler, as airport check-in would no longer be required.
26. It did not matter whether the airport built facilities additional to those required by users, provided that users were not required to fund them. The commercial risk for these excessive facilities should be entirely borne by BAA.