

BAA MARKET INVESTIGATION

Provisional consideration of possible material changes of circumstances

30 March 2011

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Summary

1. In this document we consider whether, in the light of events since March 2009, it is still right to require BAA to divest Stansted Airport, so that Heathrow, Gatwick and Stansted airports are under separate ownership, and also to divest either Glasgow or Edinburgh airports. We also consider whether we should change the order in which divestments should take place, or how long BAA has to complete each divestment.
2. On 29 March 2007, the Office of Fair Trading (OFT) referred to the Competition Commission (CC) for investigation the supply by BAA Limited (BAA) of airport services in the UK. The CC published its findings on 19 March 2009 (the 2009 report). In the 2009 report we found that a number of features of the market including BAA's common ownership of airports in south-east England and lowland Scotland gave rise to adverse effects on competition (AECs) within the meaning of section 134(2) of the Enterprise Act (the Act) in connection with the supply of airport services by BAA. In order to remedy the AECs, we concluded that a package of remedies was required. Some of these remedies in the package were unaffected by subsequent appeals and are not central to our current consideration. For the present purposes the key remedies are that BAA should divest both Gatwick Airport (Gatwick) and Stansted Airport (Stansted) and also one of either Edinburgh Airport (Edinburgh) or Glasgow Airport (Glasgow). The sale of Gatwick, was completed on 3 December 2009.
3. On 18 May 2009, BAA appealed the decision to the Competition Appeal Tribunal (CAT), on grounds of proportionality and apparent bias. BAA was successful on the ground of apparent bias but not proportionality. We appealed the CAT's decision on apparent bias to the Court of Appeal, which restored our decision. BAA sought, but was refused, permission to appeal to the Supreme Court.

4. As the challenges to the 2009 report have been dismissed, we have a duty to take action to remedy the AECs which is consistent with the decisions in the report. However, before doing so, we invited submissions on whether there were any material changes of circumstances (MCCs) or special reason such that we should amend in any way the remedies related to the divestment of Stansted and either Edinburgh or Glasgow (a Scottish airport). BAA set out what it said were MCCs which meant that we should not require the divestment of Stansted. If we were not persuaded of that, BAA said that we should amend the divestment sequence and allow longer divestment periods. BAA did not set out any special reason other than the MCCs it submitted.
5. We considered BAA's submissions. We found that the change in government policy, with the Coalition Government opposing the proposals for the third runway at Heathrow Airport (Heathrow) and SG2 at Stansted and opposing new runway development at Gatwick, was a significant development and meant that the delivery of new runway capacity, and the benefits of competition based on new runway capacity, were likely to be delayed or not take place at all. We did not find that any of the other possible MCCs put to us by BAA were significant developments since the 2009 report was published. However, we also found that since the 2009 report the scope for competition between airports within existing runway capacity has increased. Runway capacity at Stansted has been freed up, while Gatwick's new owners see scope for significant increases in passenger numbers through better use of slots and use of larger planes.
6. The remedy was put in place to address the AECs relating to common ownership, and we found that divestment of Stansted remained an effective way of addressing this. We considered a management separation remedy proposed by BAA as an alternative to divestment. We concluded that the alternative remedy would not be

substantially effective in remedying the AECs related to common ownership. The divestment remedy package remained the only substantially effective way of remedying the AEC.

7. Given that the benefits of competition based on new runway capacity were likely to be at least delayed and may not accrue at all, because of the change of government policy, we reassessed the benefits of intervention relative to the costs, taking no account of any benefits associated with new runway capacity. We found that the benefits of the divestiture remedy still significantly exceed the cost of divestment.
8. We conclude that, in relation to the requirement to divest Stansted, there are no MCCs or special reason that should lead us to take action which is inconsistent with the decisions in the 2009 report. We conclude that it remains appropriate to require BAA to sell Stansted.
9. We also find that it remains appropriate to require BAA to sell a Scottish airport.
10. We considered whether there were any MCCs or special reason to change the order of divestment of the two airports, or to lengthen the divestment periods set out in the 2009 report. We conclude that there is not. We conclude that BAA should be required to divest Stansted within a period of [X] starting from the earlier of: the date on which undertakings are accepted from BAA; or three months after the date of the final version of this document. BAA is then required to initiate the sale of a Scottish airport no later than [X] prior to the end of the period for the divestiture of Stansted, and to complete the sale no later than [X] after the end of the period for the divestiture of Stansted. The overall time frame for the divestments of the two airports is no more than [X] after the acceptance of undertakings or [X] after publication of the final version of this document.

Introduction

11. On 29 March 2007, the OFT referred to the CC for investigation the supply by BAA of airport services in the UK. The CC published its findings on 19 March 2009. In the 2009 report we found that a number of features of the reference market, including BAA's common ownership of airports in south-east England and lowland Scotland, gave rise to AECs within the meaning of section 134(2) of the Act in connection with the supply of airport services by BAA. In order to remedy the AECs, we concluded, inter alia, that BAA should divest both Gatwick and Stansted airports and also one of either Edinburgh or Glasgow.

12. On 18 May 2009, BAA appealed the decision to the CAT, on grounds of proportionality and apparent bias. In its judgment, handed down on 21 December 2009, the CAT decided that BAA had not demonstrated that the CC had failed to take account of relevant considerations, including the risk of loss of value as a relevant factor, when deciding upon the timescale for the divestments of the airports. The challenge on the ground of proportionality accordingly failed. However, on apparent bias the CAT found that a fair-minded and informed observer would conclude that there was a real possibility of bias affecting the deliberations, thinking and ultimate outcome of the investigation, and that BAA had not waived its right to object to the apparent bias. The challenge on the grounds of apparent bias accordingly succeeded.

13. We appealed the CAT's decision on apparent bias to the Court of Appeal.¹ In its judgment of 13 October 2010, the Court of Appeal concluded that the CAT was wrong to find apparent bias before 2 December 2008 and did not consider that the final decision would be considered by a fair-minded and informed observer to have been tainted by a real possibility of apparent bias. The Court of Appeal therefore allowed the appeals and restored our decision.

¹BAA did not appeal the CAT's finding on proportionality.

14. BAA sought permission to appeal to the Supreme Court. On 15 February 2011, the Supreme Court refused permission to appeal, because the application did not raise an arguable point of law of general public importance which ought to be considered by the Supreme Court at this time, bearing in mind that the case had already been the subject of judicial decision and reviewed on appeal.
15. As BAA's legal challenge to the report has failed, we are now under a duty to take action in relation to the adverse effects identified in the report. We decided in our report that BAA's common ownership of airports in south-east England and lowland Scotland, and other features of the reference market, gave rise to AECs, that a package of remedies was required, and that it was reasonable and practicable to impose structural and behavioural remedies on BAA. One of the divestment remedies, the sale of Gatwick, was completed on 3 December 2009. The focus of this document is on the divestments of Stansted and either Edinburgh or Glasgow.
16. Section 134(4) of the Act requires us, in relation to each AEC in the report, to decide whether we should take action under section 138 of the Act to remedy the AEC or the detrimental effect on customers resulting from the AEC and, if so, what action. In the 2009 report we decided that a package of remedies, including divestment of Stansted (paragraph 10.73) and divestment of one of Edinburgh or Glasgow (paragraph 10.87) would be effective to remedy the AEC, and that the divestments should be made in accordance with the timetable set out in paragraph 10.183 of the report. As a result section 183 now requires us to take action under section 159 (undertakings) or 161 (orders) to remedy the AEC and any detrimental effect on customers. In doing so, the Act requires us to be consistent with the decisions taken in the report, unless there has been an MCC or we otherwise have a special reason for deciding differently. So, before taking such action we have considered whether there has been an MCC or we otherwise have a special reason for not taking the action and applying the timetable

specified in the report. BAA submitted that since the 2009 report was published there have been MCCs affecting the market such that there should no longer be a requirement to divest Stansted (and that we should instead consider alternative remedies, including hold separate arrangements). BAA has further submitted, in the alternative, that we should change the timetable decided in our report, including allowing the divestment of the Scottish airport to take place before divestment of Stansted.

17. This document sets out the possible MCCs put forward by BAA, and our assessment of whether we need to amend any part of the remedy package in light of any MCCs or a special reason. It also refers, where appropriate, to evidence put forward by other parties who have provided evidence.²
18. As noted in paragraph 13, the decision reported in the 2009 report was restored in full by the Court of Appeal. Our focus, therefore, is to decide whether the remedies should remain as set out in the 2009 report. We have considered the submissions put forward by BAA, and considered whether there are in fact any MCCs that mean we should amend our remedy package in some way. If we conclude that the remedies should not be amended, this could be either because we have not identified any changes in circumstances which are material, or because even if we have, we find that we do not believe the MCCs merit changing the remedies.
19. No party suggested to us that there is any special reason other than an MCC for not implementing the remedies in the 2009 report.

²Only one other party put forward an additional possible MCC. Unite said that the divestment of Gatwick was an MCC. We deal with this in footnote 29.

The MCCs put forward by BAA

20. In its 15 December 2010 submissions on MCC (the BAA submission),³ BAA said that there had been MCCs since the publication of the 2009 report which justified changes in the remedies. BAA set out three matters it said were MCCs; in our view, their submission contains four specific changes in the market that may be MCCs, and we address each of them in turn:

- (a) Government policy on new runway capacity in the South-East had changed; the Coalition Government had signified its opposition to new runways at Heathrow, Stansted and Gatwick. BAA said that this change in government policy would be for the foreseeable future, and that it nullified the basis relied upon in the 2009 report for the AEC and the requirement to divest Stansted in addition to Gatwick (see Section A of the BAA submission).
- (b) There had been a substantial decline in traffic levels at Stansted. BAA attributed this to low-cost carriers (LCCs) changing their business model and taking a pan-European view of the market, with consequent competition between Stansted and non-BAA airports for LCC routes.⁴ It said that this put LCCs in a strong position to constrain Stansted's ability to raise charges, or reduce quality or range of services (see paragraphs 62 to 79 of the BAA submission).
- (c) BAA said that Heathrow's position as a hub airport had strengthened in the time since the 2009 report, such that the extent to which Heathrow and Stansted were effective substitutes for each other had materially reduced (see paragraphs 80 to 87 of the BAA submission).
- (d) There had been a significant fall in the level of Stansted's profitability, and considerable uncertainty around the airport's future prospects (see Section C of the BAA submission).

³www.competition-commission.org.uk/inquiries/ref2007/airports/pdf/baa_submission_on_mcc_non_confidential_version.PDF.

⁴We did not define specific markets in the 2009 report, but in paragraph 3.168 of the 2009 report we found that BAA airports are the closest demand substitutes for one another.

21. BAA submitted (in Section D of the BAA submission) that as a result of these MCCs we should no longer require divestment of Stansted. If we were not persuaded of this, BAA submitted that we should allow the sequence of airport divestments to be reversed, so that a Scottish airport could be sold before Stansted. It also submitted that we should increase the length of the divestiture periods for these two divestments beyond that set out in the 2009 report, and hence the overall timescale for the divestments.⁵

The impact of the proposed MCCs

22. We consider what impacts the proposed MCCs raised by BAA have had on each of the following aspects of the divestment remedies:
- (a) the requirement to divest Stansted;
 - (b) the requirement to divest a Scottish airport;
 - (c) whether to require simultaneous divestments or allow sequential divestments;
 - (d) the order in which the airports should be divested; and
 - (e) the timescale for divestments.

The requirement to divest Stansted

23. In this section, we consider the impact of the possible MCCs on the requirement to divest Stansted.

The change in government policy

BAA's submission

24. BAA's submission on this point can be found in Section A of the BAA submission. In summary, the Coalition Government agreement of 20 May 2010 expressed opposition to the third runway at Heathrow and additional runways at Gatwick and Stansted (paragraphs 12 and 13); the Labour Opposition opposed new runways at

⁵BAA said that it did not have new arguments to bring regarding the need to divest a Scottish airport, though it did say that the market conditions applying to Stansted also applied in Scotland and so to that extent there were impacts on the timing of divestiture.

Gatwick and Stansted in its election manifesto, and, whilst it supported a third runway at Heathrow in that document, its newly elected leader has indicated opposition to this (paragraph 14). For the foreseeable future, therefore, BAA said that government policy was most likely to oppose runway development (paragraph 15).⁶

Our assessment of the change in government policy

25. It is clear from public announcements and the Coalition Agreement that government policy on runways is currently to oppose new runways at Heathrow, Gatwick and Stansted.
26. During the course of the investigation the then opposition parties' positions on a third runway at Heathrow became clear. The Conservative party was raising concerns on a third runway at Heathrow on environmental grounds in November 2007,⁷ and by September 2008 had clearly articulated its opposition to a third runway.⁸ The Liberal Democrats were also opposed to a third runway at Heathrow.⁹
27. We considered whether government policy on new runways would be reconsidered in the near future. In recent months Gatwick,¹⁰ the City of London Corporation¹¹ and

⁶In an oral hearing, BAA suggested that the change in government policy meant that it would probably be a minimum of [redacted] years before it was in the position it was in regarding new runways in 2009.

⁷In November 2007 the then Conservative Shadow Transport Secretary Theresa Villiers said: 'We recognise that the economic arguments for expanding Heathrow are much stronger than any other airport in the South East'. However, she said that 'before a decision can be made on this critically important issue, we believe that four tests must be met—on NOx pollution, on noise, on alternative ways to meet demand and free up capacity, and above all, on meeting our climate change targets' (see: www.conservatives.com/News/News_stories/2007/11/Heathrow_expansion_has_to_satisfy_four_key_environmental_tests.aspx).

⁸See: www.conservatives.com/News/News_stories/2008/09/Giving_the_green_light_to_high_speed_rail.aspx). The then Conservative Shadow Transport Secretary Theresa Villiers set out in January 2009 the reasons for the Conservative's opposition to a third runway at Heathrow: 'A third runway at Heathrow would inflict devastating damage to the environment and to the quality of life of millions of people and the Conservatives will fight them every step of the way.' The concerns included: pollution from a third runway would increase the risk of serious illness and early death around the airport; the impact of aircraft noise from Heathrow on constituents from Greenwich to Reading; and the large increase to carbon emissions. (See: www.conservatives.com/News/News_stories/2009/01/Third_runway_at_Heathrow_will_be_an_environmental_disaster.aspx).

⁹The Liberal Democrats have opposed a third runway at Heathrow since at least January 2009, citing environmental damage, the cost of that damage, and saying that a third runway was not needed to keep London competitive (see, for example: www.libdems.org.uk/press_releases_detail.aspx?title=Heathrow_expansion_will_lose_UK_billions_says_Kramer_&pPK=19c3ff49-f8f8-42b0-8627-095abc74b41a).

¹⁰Letter to the *Financial Times*, published 11 January 2011. Also, the Chair of Gatwick Airport, Sir David Rowlands, said at a conference on 26 January 2011: 'It is total nonsense to suggest building a high-speed rail network means there is no need to develop airports in the south east' (see: www.travelweekly.co.uk/articles/2011/01/26/35906/former+advisor+slams+governments+high-speed+rail+policy.html).

¹¹See: www.cityam.com/news-and-analysis/corporation-renews-call-third-runway.

the Mayor of London¹² have been calling for new runway capacity in the South-East.¹³ [§] we noted that in March 2011 BAA was reported to have welcomed remarks by the Mayor of London criticizing the Government's refusal to discuss any new runways.¹⁴ Ryanair said that 'Regardless of the current position of the Coalition Government, it is scarcely credible that UK Governments will, in the medium term, be capable of resisting the need for further (appropriately located, regulated and constructed) additional runway capacity'.¹⁵ BAA said that there was 'absolutely no basis' for the CC to rely on Ryanair's 'unsubstantiated claim'.

28. The DfT's Business Plan sets out the Government's commitment to create a sustainable framework for UK aviation. The Government is publishing '*Developing a Sustainable Framework for UK Aviation—Scoping Document*' on 30 March 2011. The scoping document will ask strategic questions to inform the development of a new aviation policy framework, which will be published for formal consultation in March 2012 and formally adopted by March 2013. However, [§].
29. BAA told us that the change in government policy was an MCC. Ryanair told us that the change was entirely predictable during the original investigation and was therefore not an MCC.
30. We accept that opposition parties made clear in public their opposition to new runway capacity during the course of the original investigation. However, in our view the fact that there has been a change in government policy on runway capacity is a significant development for the UK aviation industry.

¹²The Mayor has been primarily promoting a new hub airport in preference to new runways at existing south-east airports. The Mayor is opposed to a third runway at Heathrow (see paragraph E6 of [A New Airport for London—part 1: The case for New Capacity](#) (January 2011)).

¹³Moreover, London First said that the Government should consider all options for London's air transport infrastructure based on their merits and the UK's long-term prosperity, saying that demand in London alone was forecast to rise to 250 million passengers a year by 2030, whilst current airport capacity limited trips to around 140 million passengers a year (see www.london-first.co.uk/news/news-by-date/detail.asp?record=201).

¹⁴Johnson attacks "crazy" airport policies', *Financial Times*, 17 March 2011.

¹⁵Representations by Ryanair Limited as to the remedies to be imposed on BAA Limited, paragraph 13.

31. Given the evidence in paragraphs 24 to 27, we believe that it is unlikely that the Coalition Government will support new runway capacity in the South-East in at least the near future, and as a result the introduction of such new runway capacity into the region will be delayed or not take place at all—in effect the impact is at least to delay it. We recognize that government policy can change (as it did in 2010), but we cannot predict if or when new runway capacity in the South-East will be introduced.
32. Government policy is therefore likely at least to delay the introduction of new runway capacity in the South-East, and possibly prevent it altogether. As a result, government policy is also likely at least to delay the competitive benefits to be expected from new runway developments, and possibly to prevent the benefits accruing altogether.

The implications of the change in government policy

BAA's submission

33. BAA's submission on this point can be found in Section A of the BAA submission. In summary:
- The AEC finding and the requirement to divest both Gatwick and Stansted were principally because of the potential for competition in relation to the development of new capacity (paragraph 26).¹⁶
 - The main benefits of the divestments would result from the dynamic aspects of competition. Absent such new capacity, there are only service quality and modest pricing benefits available—and moreover the ability to compete on service quality is dependent on the availability of capacity (paragraph 27, referring to paragraph 23 and text from the 2009 report at paragraphs 12 and 10.10(b)).

¹⁶Similarly, in an oral hearing BAA said 'new runway capacity is an important, indeed, a fundamental and perhaps the major point within the final report'.

- With the change in government policy there is no scope for new runway capacity in the foreseeable future, and the CC could no longer conclude that most of the expected benefits of separate ownership—competition between airports in relation to planning and capacity development, price competition and competition to improve service quality (paragraph 22)—would arise. BAA said that government policy had changed so radically as to invalidate the effectiveness of the remedy (paragraph 29 of the BAA submission), and this radical change nullified the basis relied upon in the 2009 report for the AEC findings and the requirement to sell Stansted (paragraph 30 of the BAA submission). It said that the 2009 report did not reach a conclusion on whether competition within current constraints would justify the finding of an AEC or the divestment of Stansted.

34. We consider first the extent to which the requirement to divest Stansted relied on the potential for competition in relation to the development of new runway capacity. We look at what we said in the 2009 report about the purpose of divesting Stansted and what the 2009 report said about the prospects for new runway capacity. We then conclude on the importance of new runway capacity for the requirement to divest Stansted.

35. We then go on to address BAA's second point, by looking at what benefits could be expected from divestment in the absence of new runway capacity.

36. BAA's third point—that the effectiveness of the remedy has been invalidated and the basis relied upon in the 2009 report for the AEC findings and the requirement to sell Stansted has been nullified—is dealt with through a reassessment of the effectiveness and proportionality of the divestment remedy (see paragraphs 115 to 149).

What the 2009 report said about the purpose of divesting Stansted

37. We start by considering why we concluded in the 2009 report that divestment of Stansted was necessary.
38. The Act¹⁷ requires the CC to take action to remedy each AEC, or any detrimental effects on customers, that may result from the AEC. The AEC findings in Section 8 noted three AECs related to common ownership in London. These were:
- (a) 'Common ownership of the three BAA London airports is a feature of the market which prevents competition between them (see paragraph 5.42(b)). The intensity of that competition may initially be limited by current capacity constraints and price controls, but these constraints are themselves at least in part the result of common ownership.' (Paragraph 8.4(a)(ii).)
 - (b) 'Common ownership of the BAA London airports is also a feature of the market that, inter alia, restricts or distorts competition between airports in relation to capacity development.' (Paragraph 8.4(a)(iv).)
 - (c) 'Common ownership of the BAA London airports also exacerbates the inadequacies of the regulatory system, reducing the benefits of regulation and distorting competition between airlines.' (Paragraph 8.4(a)(v).)
39. Runway capacity constraints as such were not considered in the report to be a feature of the market. None of the remedies, therefore, were intended specifically and solely to address the issue of an AEC arising from runway capacity. The key problem being addressed was set out in paragraph 9.1:
- BAA's ownership of the four south-east airports prevents any competition between them ... In the London area there is an almost complete absence of competition and almost total market failure ... Airlines and passengers at BAA's airports have either been entirely deprived, or

¹⁷Section 138.

substantially deprived, of the innovation, enterprise and concern for their interests that competition brings. These shortcomings, which are extensive, have been felt by airlines and passengers alike in prices and/or quality of service ...

leading to a conclusion that there was 'no competitive market for airport services' (paragraph 9.2). In terms of the consequences, in paragraph 9.3 we said:

The consequences of common ownership and the absence of competition are most obvious in aspects of BAA's performance—its lack of engagement with its airline customers, insufficient strategic management of the airports, inefficient investment by BAA at airports in the South-East in particular, and an unsatisfactory passenger experience at many BAA airports.

40. The 2009 report clearly finds that the AEC in question is driven by common ownership. The purpose of the remedy requiring the divestment of Stansted is to address the AECs of common ownership as they relate to Stansted and its interaction with Gatwick and Heathrow. Addressing the AECs puts in place the conditions for all forms of competition to develop.

What the 2009 report said about the prospects for new runway capacity

41. BAA cited extracts from the 2009 report (paragraphs 5.33 and 10.117). BAA's line of reasoning is that an assumption of government support for new runway capacity was central to the report's reasoning (paragraph 21 of BAA's submission) and without that assumption of support the reasoning was undermined (paragraph 29 of the BAA submission).

42. In fact we did not assume in the 2009 report that new runway capacity in the South-East would necessarily be forthcoming over the next several years.¹⁸ For example, we noted that ‘There is as yet no certainty on the implementation of plans for additional runway capacity at either Stansted or Heathrow, the earliest date for which is unlikely to be before 2017’.¹⁹ We also noted that government support for a third runway at Heathrow was contingent on stringent environmental requirements being met,²⁰ and that new runways might not be constructed, because of a failure to receive planning permission.²¹
43. It was, and is, our view that government support (or indeed the government’s desire for a new runway) appears to be a prerequisite for a new runway. However, government support in itself is not enough, as there are other hurdles, most notably the planning process, to overcome.

The importance of new runway capacity for the requirement to divest Stansted

44. In the 2009 report the AEC related to common ownership. The requirement to divest Stansted was part of a remedy package designed to remedy the AEC.
45. Our assessment of the effectiveness and proportionality of the remedies did nevertheless take account of the benefits that would be expected from the introduction of new runway capacity.
46. However, these were not the only benefits of which we took account. We now go on to look at the benefits associated with competition in the absence of new runway competition.

¹⁸In terms of the timing of any new capacity, we said in paragraph 4.15(c) of the 2009 report: ‘Government policy, as set out in the White Paper and subsequent statements, supports new runway and associated terminal capacity at Heathrow and at Stansted, and may potentially lead to more capacity, subject to environmental requirements being satisfied and the final outcome of planning inquiries, by around 2017 at Stansted and 2020 at Heathrow.’

¹⁹Paragraph of the Introduction of the 2009 report.

²⁰Paragraph 10.38 of the 2009 report.

²¹Paragraph 10.170 of the 2009 report.

The scope for competition absent new runway capacity

47. In this section we look at what we said in the 2009 report about the scope for competition in the absence of new runway capacity, and developments since the 2009 report including whether, since BAA's sale of Gatwick, there has been any evidence of competition developing.

- *What we said in the 2009 report*

48. As noted in paragraph 32, BAA said that there were only service quality and modest pricing benefits available in the absence of new runway capacity—and moreover that the ability to compete on service quality was dependent on the availability of capacity. We look here at what we said in the 2009 report about competition in the absence of new runway capacity.

49. As a precursor, we consider what we said about how competition occurs. In paragraph 6 of the summary of the 2009 report, we noted that the competition observed between non-BAA airports in the UK is generally between airports with spare runway capacity or runway capacity that can readily be expanded. BAA said that this paragraph showed that 'competition between airports is generally between airports with spare capacity or capacity that can readily be expanded'. However, the paragraph does not address the question of competition where there is not spare runway capacity.

50. In paragraph 5.17 of the 2009 report, we set out 'that separate ownership of Stansted would result in significant competitive interactions between it and both Heathrow and Gatwick'. We then cited five competitive interactions:

(a) Gatwick is the closest substitute for Stansted and Stansted is the second-closest substitute for both Heathrow and Gatwick.

- (b) The strong substitutability between Gatwick and Stansted stems from the combination of catchment overlaps and the significant presence of LCCs at both airports.²²
- (c) In recent years, many of the competitive pressures on short-haul services at Heathrow have come from the growth of LCCs at Stansted (see paragraph 3.123).
- (d) Only Stansted and Heathrow have government support for new runways. Separate ownership of these two airports gives the opportunity for them to compete on the design, cost and timing of major increments of capacity.
- (e) Following the building of a second runway at Stansted, Stansted would have a substantial share of London airport runway capacity (about 30 per cent—see Table 5.1) even after a third runway is constructed at Heathrow. We would expect Stansted to seek to attract airline business from the other airports, and for them to respond. The process of rivalry to win and retain airlines will induce the airports to improve their offerings to the benefit of airlines and customers.

51. The last two of these competitive interactions relate to new runway capacity. The first three do not, and we still regard them as significant.

52. BAA's assessment is that the benefits of divestment without new runway capacity are limited. BAA said:

In relation to service quality, the Report found (Summary paragraph 12) that lack of capacity, particularly runway capacity, at the South East airports is a **main** reason for the current poor standards of service at the airports and lack of resilience at times of disruption. This recognises

²²LCCs account for about 90 per cent of ATMs at Stansted and an increasing percentage at Gatwick, where both full service scheduled and charter flights have declined and where easyJet has replaced BA as the largest airline.

that there is a significant relationship between capacity constraints and the ability to compete on service quality (also Report paragraph 10.41(b)). [BAA's emphasis on the word 'main'.]

53. The 2009 report identified two aspects of service that may be affected by lack of runway capacity: (i) standards of service; and (ii) lack of resilience. BAA has focused only on the first of these.
54. In the 2009 report, we noted that significant benefits may be expected to come from competition in relation to the development of runway capacity, and once there is spare runway capacity allowing for greater availability of runway slots. However, there is extensive consideration of the benefits of divestment in the absence of new runway capacity—in particular, there is an entire appendix (Appendix 5.1) which looks at the potential for competition between BAA airports within existing runway capacity constraints. Further, Appendix 10.1 looks at the need to divest both Gatwick and Stansted, focusing on both new-runway-related competition and non-new-runway-related competition.
55. We noted in the 2009 report that in the absence of any previous competition between the south-east airports it is difficult to know what forms competition will take. However, it lists several ways competition may be expected to manifest itself even within existing runway capacity constraints (Appendix 5.1, paragraph 6):
- in relation to Stansted and Gatwick, competition to fill off-peak slots either by rebalancing peak/off-peak landing charges or by offering greater off-peak discounts to individual airlines;²³
 - in relation to Heathrow and Gatwick, competition to increase passenger numbers by rebalancing the landing and per-passenger charge;

²³We considered this scenario in [Appendix B of our Stansted Q5 report](#).

- in relation to all three of BAA's London airports, competition for users by improving service quality; and
 - also in relation to all three of BAA's London airports, competition via different commercial strategies, eg for higher-value users such as airlines which convey a higher number of passengers per air transport movement (ATM) or those passengers who contribute disproportionately to retail revenues.
56. We concluded in the 2009 report that, in the absence of new runways, 'competition to invest and innovate, even in the short term, could be intense' (Appendix 5.1, paragraph 4). We also saw scope for some price competition (albeit modest in scale and largely confined to competition to fill spare off-peak capacity²⁴).
57. The report also noted that 'traffic volume at all London airports is currently declining. To the extent this results in more spare capacity, there may be more scope for price competition within existing constraints' (paragraph 5.12, footnote 1). We consider this point further in paragraph 61.
58. In the 2009 report, we noted that the full range of benefits of the sale of Stansted could not be predicted with precision, given BAA's uninterrupted common ownership of the three largest airports in the South-East (see paragraphs 9.2 and 10.67), and the potential that separate ownership of the three airports changes and enhances the way the market serves customers. In the 2009 report, we assessed the benefits of divestiture in qualitative terms, comparing the benefits of commercial rivalry as seen in the comparator airport pairs with the disadvantages of there being no such rivalry in the BAA airports. The absence of such rivalry resulted 'notably in the absence of responsiveness to customers, quality of service deficiencies and a failure to ensure operating excellence' (paragraph 10.105 of the 2009 report).

²⁴See Appendix 10.1, paragraph 24, of the 2009 report.

- *Developments since the 2009 report*

59. We looked at whether there were any signs of competition developing in the South-East since the divestment of Gatwick. In doing so, we recognized that Gatwick has only been under new ownership for little more than one year,²⁵ and we would not expect vigorous competition between airports to develop fully in such a short time frame. For the reasons set out below, we find that there are some tangible signs already of non-price competition to attract airlines and their customers by Gatwick, and a scheme aimed, among other things, at encouraging airlines to switch long-haul flights to Gatwick using financial incentives (see paragraph 64), though there is as yet very little actual switching based on lower prices.
60. Gatwick provided us with a list of changes since it had been under separate ownership. These are set out in Appendix A.²⁶ These were primarily related to service quality and innovation and we consider these first; we consider changes relating to price competition from paragraph 61. easyJet said that there had been some positive improvements to the airport, particularly on the passenger experience side,²⁷ and Ryanair said that Gatwick management had made the passenger experience at the airport more pleasant, and that it had noticed improvements in the security area, as well as increased productivity.²⁸ BAA said that Gatwick's submission lacked any real detail on the emergence of competition since December 2009. Unite said that there had not been any discernible change to the level of competition since the sale of Gatwick, which it considered to be an MCC.²⁹ It said that 'contractors have been put under considerable pressure to deliver their services for less',³⁰ and that 'one airline at Gatwick has stopped using one of the ground handling companies simply because

²⁵As noted in paragraph 15, the sale of Gatwick was completed on 3 December 2009.

²⁶Gatwick's comments on what has happened since its change of ownership can be found in submission from Gatwick Airport, pp2-4, and summary of a hearing with Gatwick Airport and GIP, paragraphs 5-27.

²⁷Summary of a hearing with easyJet, paragraph 12.

²⁸Summary of a hearing with Ryanair, paragraph 11.

²⁹Unite response to the CC Review of their decision regarding the future of BAA Airports, paragraph 1.3. We do not agree that the implementation of one part of the remedies package constitutes an MCC in itself. We set out in Appendix 10.1 of the 2009 report why divestment of Gatwick airport alone was insufficient.

³⁰Unite response to the CC Review of their decision regarding the future of BAA Airports, paragraph 1.7.

the quality of the service has been so poor'.³¹ We noted, however, that ground handling is a separate activity that is the responsibility of the airlines rather than the airport.³²

61. In our view, as noted in Appendix A, there are tangible signs already of non-price competition for airlines and their customers by Gatwick, for example in terms of improving the customer security experience, development of baggage facilities and its capital expenditure process.
62. In the 2009 report, we also found scope for modest price competition. We note that the level of price competition envisaged was not sufficient to remove the need for price caps at Stansted and Gatwick before new runway capacity became available (see paragraph 10.344 of the 2009 report). We also note that since the 2009 report Stansted's passenger numbers and ATMs have dropped, freeing up new runway capacity (see paragraphs 78 to 82), and that Gatwick told us that, with better use of the slots and maybe larger and fuller planes, it believed it could increase its runway capacity from approximately 32 million to maybe 45 million.³³ The report also considered that 'traffic volume at all London airports is currently declining. As noted in paragraph 56, to the extent that this results in more spare runway capacity, there may be more scope for price competition within existing constraints.'³⁴ In our view, the conditions for some price competition across all three main London airports, based on spare runway capacity at Stansted and Gatwick, have been created, and this can develop if the operators of those airports take advantage of the opportunity—something which would be more likely if Heathrow and Stansted were under separate ownership (see Appendix 10.1 of the 2009 report).

³¹Unite response to the CC Review of their decision regarding the future of BAA Airports, paragraph 4.8.

³²Gatwick confirmed that there were some problems regarding easyJet's baggage reclaim contract, and it had worked to ensure that the problems were resolved quickly.

³³Summary of a hearing with Gatwick Airport and GIP, paragraph 28.

³⁴Paragraph 5.12, footnote 1.

63. However, both Ryanair and easyJet commented on a lack of price competition from Gatwick since it came under separate ownership. Ryanair said that Gatwick was not competing with other south-east airports. Ryanair said that since divestment Gatwick had not been acting competitively; it noted that Gatwick had announced its intention to price up to the price cap in 2011/12, and said that in its view Gatwick would only behave competitively in the event that it came under competitive pressure from Stansted—something that it said would not happen unless Stansted were under separate ownership from BAA.³⁵ easyJet said that it had seen very little switching, and ‘certainly no generous offers to encourage traffic’.³⁶
64. Ryanair also said that separate ownership of Gatwick had not stimulated a competitive response by Stansted.³⁷ BAA noted this and said that there was no rational basis for a view that Gatwick’s competitive behaviour depended on the ownership status of Stansted, and that it would be perverse for the CC to require BAA to divest Stansted to make Gatwick behave more competitively. We noted BAA’s comments; however, the purpose of the remedy requiring divestment of Stansted is to encourage competition between all three airports in the South-East.
65. One of the changes Gatwick has introduced under separate ownership does relate to price competition. It has introduced a long-haul incentive programme. Gatwick told us that under this initiative it shared some of the risk of start-up of new long-haul routes for three years. It told us that this had been well received by some of its long-haul airlines and they had started to use the benefits of that programme. It told us that it was targeting 23 long-haul operators, and to date the incentive scheme had been taken up by three airlines ([redacted]). The [redacted] involved [redacted] switching from Heathrow to Gatwick; the other [redacted] flights were new to Gatwick. Whilst this scheme has not yet

³⁵Representations by Ryanair Limited as to the remedies to be imposed on BAA Limited, paragraph 30.

³⁶Summary of a hearing with easyJet, paragraph 11.

³⁷Representations by Ryanair Limited as to the remedies to be imposed on BAA Limited, paragraph 29.

resulted in much switching to Gatwick from other airports, it appears to us to show a willingness to innovate on pricing structures in an attempt to attract business, and has started to achieve some success in terms of winning business from other airports.

66. We have not yet seen any significant switching of airlines based upon price, though, as noted in paragraph 58, Gatwick has only been under separate ownership for just over a year. However, there has been some switching of airlines from Stansted to Gatwick since the 2009 report's publication. Gatwick said that the main attraction of Gatwick for switching airlines was a strong catchment area, but that the airlines would also have looked at the way service improvement was being driven through when deciding to switch to Gatwick. We would, however, expect the benefits of divestment to take several years to have full effect, and for Stansted also to be divested for the full benefits of separate ownership to be achieved.
67. Gatwick said that there was active competition between airports in the South-East, with airlines expanding the number of services from Gatwick and taking the opportunity to switch their services between competing airports. BAA said that this supported its analysis that Stansted faced effective competition from UK and European airports (other than Heathrow), and that separate ownership of Heathrow and Stansted would add nothing to the powerful competitive constraints already acting on Stansted.
68. We discuss the constraint from non-UK airports in paragraphs 83 to 90. To the extent that Gatwick and Stansted are now in competition, we would expect the competitive constraint on Stansted to have increased, but that would not remove the need for Stansted and Heathrow to be under separate ownership. We set out in paragraphs 10.46 to 10.54 and Appendix 10.1 of the 2009 report why we believed that BAA's

ownership of Heathrow and Stansted was a feature that gave rise to an AEC, even in circumstances in which Gatwick has been divested. In summary:

- (a) We found that a significant number of their non-transfer passengers viewed Heathrow and Stansted as close or effective substitutes for each other (paragraph 10.47), and we believed that substitution by non-transfer passengers would influence the decisions taken by the operators of Heathrow and Stansted (paragraph 10.48).
- (b) We did not accept BAA's view that airport operators could not influence the choice passengers made in relation to which airport they flew from or to (paragraph 10.49).
- (c) We also disagree with BAA that excess demand at Heathrow precludes competition between Heathrow and Stansted from emerging. This view ignores the dynamic element of rivalry and the distortions that common ownership would give rise to in this respect. Specifically, in adopting this view BAA overlooks the constraint Heathrow could provide on Stansted through capacity expansion and/or improvements to service quality (see paragraph 10.50 of the 2009 report). It also overlooks the possibility that competition from Stansted on short-haul feeder flights, which are vital to the profitability of long-haul services, could over time erode Heathrow's position as a hub. This prospect provides a strategic incentive to Heathrow to offer better conditions (either in terms of price or service) to its established airline customers in order to protect the profitability of such services (see paragraph 10.51 of the 2009 report).
- (d) We also thought that the then Government's support for a second runway at Stansted increased the likelihood of the next round of runway capacity being at Heathrow and Stansted, as envisaged by the White Paper, and hence that continuing common ownership of Heathrow and Stansted would prevent competition between them in the design, cost, timing and allocation of this particular capacity (see paragraphs 10.52 and 10.53 of the 2009 report).

69. The last of these reasons was based on government support for new runway capacity, which has been at least delayed. However, the first three reasons remain. Moreover, the reduction in passenger numbers using Stansted, and ATMs at Stansted, means that there is now significantly more spare runway capacity at Stansted than there was in 2009, which further strengthens the prospects of Stansted being able to compete with Heathrow as set out in subparagraph (c). In our view, it is clear that there could be competition for customers and airlines between Heathrow and Stansted under separate ownership without new runways being built.³⁸

70. Overall, without new runways being built, there could now be a significantly greater level of competition for customers and airlines between Heathrow and Stansted if they were under separate ownership than we predicted in the 2009 report. This is a result of the extra spare capacity at Stansted created by the decline in passenger numbers and ATMs since the 2009 report. There is evidence from Gatwick's actions since it came under separate ownership of actions to improve the customer experience and encourage airlines to use Gatwick. This evidence is encouraging, though we do not place great weight on it in the light of our findings in the 2009 report on the scope for competition absent new runway capacity, as Gatwick has not been under separate ownership for very long.

- *Conclusions on the scope for competition absent new runway capacity*

71. In the 2009 report we found that competition to invest and innovate, even in the short term, could be intense. There is evidence that, since it came under separate ownership, Gatwick's management has taken actions to improve the customer experience and encourage airlines to use Gatwick. This evidence is encouraging, though we do not place great weight on it (see paragraph 69).

³⁸Given the scope for increased capacity at Gatwick (see paragraph 61), we similarly see scope for Gatwick to compete with Heathrow and Stansted without new runways being built. However, our focus here is on competition between Heathrow and Stansted, as Gatwick is already under separate ownership.

72. In 2009 we also found scope for modest price competition. We have found that the reduction in passengers and ATMs at Stansted since 2009 means that there is now significantly more spare runway capacity at Stansted. It is clear that there could be significantly more competition for customers and airlines between Heathrow and Stansted under separate ownership without new runways being built than we envisaged in 2009.
73. In considering the scope for competition absent new capacity, the 2009 report also found that under separate ownership the CAA would be able to collect three sets of accounts produced by independent operators allowing it to benchmark their performance through a process known as comparative competition (paragraph 6.64). We noted that this had the potential to reduce the costs of regulation significantly (paragraph 6.65) and that the improvements in service quality as a result of comparative competition could also be significant (paragraph 6.72).

Conclusions on the change in government policy

74. The change in government policy is a significant development since 2009 which is likely at least to delay the introduction of new runway capacity in the South-East, and possibly prevent it altogether. As a result, government policy is also likely at least to delay the competitive benefits to be expected from new runway developments, and possibly to prevent the benefits accruing altogether.
75. Government support for new runways is one necessary condition for new runways to be built, and our 2009 assessment of the effectiveness and proportionality of the remedies took account of the benefits that would be expected from the introduction of new runway capacity.

76. However, these were not the only benefits of which we took account. We also found that competition to invest and innovate, even in the short term, could be intense. We found scope for modest price competition. We have now found that the reduction in passengers and ATMs at Stansted means that there is significantly more spare runway capacity at Stansted than there was in 2009. There could be significantly more competition for customers and airlines between Heathrow and Stansted under separate ownership without new runways being built than we envisaged in 2009.
77. We conclude that it is appropriate to reassess the effectiveness and proportionality of the requirement to divest Stansted, taking no account of the benefits that we expected to accrue from new runway capacity, but taking account of an enhanced scope for competition on price based upon increased spare capacity at Stansted (see paragraphs 115 to 149).

The decline in traffic at Stansted

78. The second MCC put forward by BAA was that there had been a substantial decline in traffic levels at Stansted. We note first what BAA said were its cause and consequences. We then look at the evidence for a decline in traffic at Stansted. We go on to consider the implications of this for the constraint imposed on Stansted by non-BAA airports, and BAA's argument that Stansted's two largest airline customers have an enhanced level of buyer power as a result of the decline in traffic. Finally, we conclude on the implications of the decline in traffic at Stansted.

BAA's submission

79. BAA said that there had been a substantial decline in traffic levels at Stansted, which it attributed to LCCs taking a pan-European view of the market, with a consequent constraint from non-BAA airports putting LCCs in a strong position to constrain

Stansted's ability to raise charges, or reduce quality or range of services³⁹ (see paragraphs 62 to 79 of the BAA submission). BAA also pointed us to the annexes of Ryanair's submission, which it said showed that Ryanair's position supported BAA's view that Stansted competed head-to-head with a large number of UK and European airports.

Has there been a decline in traffic at Stansted?

80. The 2009 report relied on a mixture of 2007 and 2008 data when considering the size of Stansted. In terms of passenger numbers, the 2009 report showed the number of passengers using the airport in 2007 and 2008. In Table 1 we update these numbers with data on annual passenger numbers for 2009 and 2010. Figure 1 shows the number of passengers each month of 2008, 2009 and 2010,⁴⁰ and Figure 2 shows the percentage change in number of passengers using Stansted each month over those years.

TABLE 1 Number of passengers using Stansted, 2007 to 2010

	2007	2008	2009	2010
Number of passengers (m)	23.759	22.340	19.950	18.565

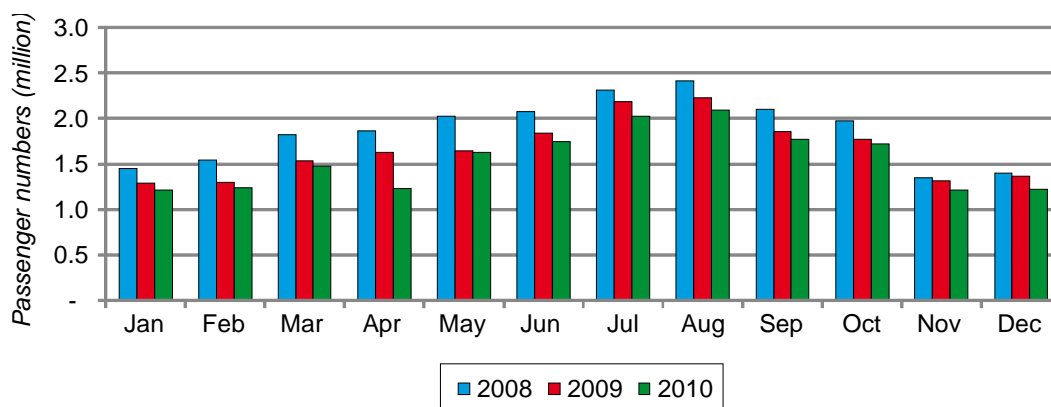
Source: CAA website for 2007–2009, 2010 data from BAA.

³⁹BAA's submission combined a materially increased constraint from LCC airports with a materially reduced constraint imposed on Stansted by Heathrow to argue that divestment was disproportionate. We consider the two proposed changes separately. We do not find evidence that either constraint has changed significantly, and we do not find the impact of the two combined to be significant.

⁴⁰On 11 February 2011 BAA reported that traffic at Stansted in January 2011 was 5.8 per cent lower than in January 2010 (see: www.baa.com/portal/page/BAA%20Airports%5EMedia%20centre%5ENews%20releases%5EResults/6b289ad3e80fd210VgnVCM10000036821c0a____/a22889d8759a0010VgnVCM200000357e120a____/).

FIGURE 1

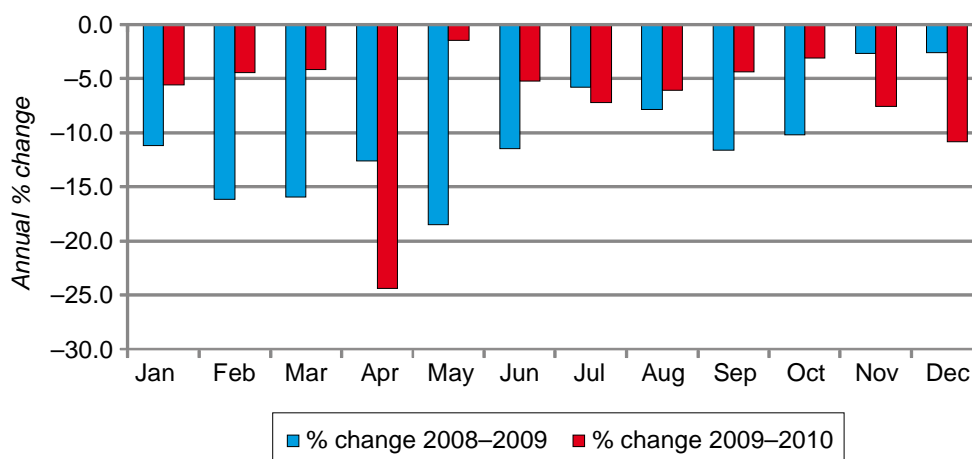
Passenger numbers by month at Stansted, 2008 to 2010



Source: CC analysis of CAA data; October–December 2010 data sourced from BAA.
 Note: April 2010 = volcanic ash disruptions.

FIGURE 2

Percentage change in passenger numbers at Stansted, 2008 to 2010



Source: CC analysis of CAA data; October–December 2010 data sourced from BAA.
 Note: April 2010 = volcanic ash disruptions.

81. The data in Table 1, Figure 1 and Figure 2 shows that there has been a significant fall in the number of passengers using Stansted since the 2009 report was published.

82. We also looked at the number of ATMs at Stansted. Table 2 shows the number of ATMs at Stansted in each of the years 2007 to 2010. Figure 3 shows the number of ATMs by month in the years 2008 to 2010, and Figure 4 shows the percentage

change in those figures between years. All this data shows that there has been a reduction in ATMs at Stansted since the report was published.

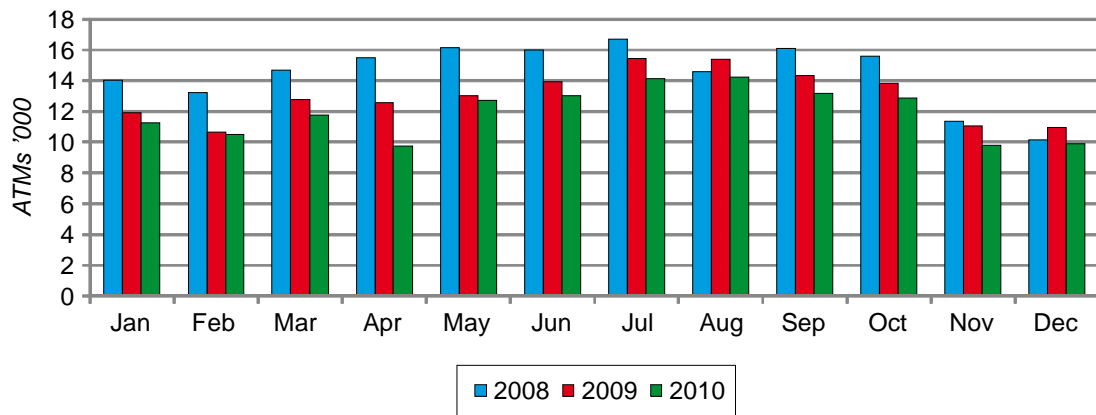
TABLE 2 Number of ATMs at Stansted, 2007 to 2010

	2007	2008	2009	2010
Number of ATMs	191,522	177,285	155,985	143,335

Source: CAA website for 2007–2009, 2010 data from BAA.

FIGURE 3

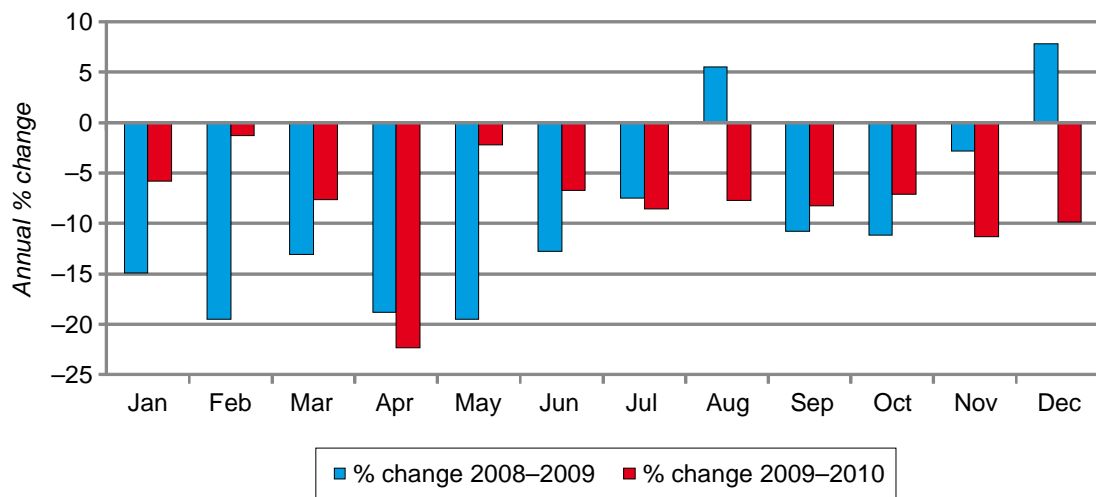
Number of ATMs by month at Stansted, 2008 to 2010



Source: CC analysis of CAA data. October to December 2010 data sourced from BAA.

FIGURE 4

Percentage change in ATMs at Stansted, 2008 to 2010



Source: CC analysis of CAA data. October to December 2010 data sourced from BAA.

83. The evidence on passenger numbers and ATMs clearly shows that there has been a reduction in both passengers and traffic since the 2009 report was published. In

terms of passengers, the trend has been downwards in every month in both 2009 and 2010. In terms of ATMs, the trend was downwards in every month overall and in 2010, though in August and December 2009 there were more ATMs than in those months in 2008.⁴¹

The constraint on Stansted imposed by non-BAA airports

84. As concluded in paragraph 82, there has been a decline in passenger numbers at Stansted since the publication of the report. This could be for a variety of reasons. BAA said that Stansted was operating in a pan-European market and the loss of passengers was because LCCs were moving to other European airports.⁴² Ryanair believed the fall was because it was too expensive for airlines to invest in capacity at Stansted and there were airports elsewhere with capacity where investment was more attractive.⁴³
85. Ryanair also said that BAA did not price competitively so as to incentivize growth at Stansted and in consequence did not manage the airport efficiently, and that BAA's management was taking no action to encourage growth at Stansted.⁴⁴ BAA said that it was an unproved claim that it was taking no action to encourage growth, and that in fact there was clear evidence on its efforts in the dialogue on airport charges proposals in the annex to Ryanair's submission.
86. easyJet said that one of the reasons for the decline was the recession (it also noted that it had maintained the number of its planes based at Stansted).⁴⁵ BAA also told

⁴¹BAA also told us that since January 2009 (the last monthly data available before the 2009 report was published) the trailing 12-month total passenger volume (MAT) at Stansted had fallen by 3.8 mppa or 17 per cent.

⁴²It said that the drivers for this were primarily: changes in relative taxation of aviation across different countries; strategic developments by LCCs in relation to other European markets; and an increase in yields that LCCs have been able to achieve in these markets relative to Stansted and the UK more generally.

⁴³Summary of a hearing with Ryanair, paragraph 1.

⁴⁴Representations by Ryanair Limited as to the remedies to be imposed on BAA Limited, paragraphs 28 and 29.

⁴⁵Summary of a hearing with easyJet, paragraph 5.

us that the recession had been a factor in Stansted's decline in passenger numbers.

Colin Matthews, the BAA CEO, told us that:

the economic recession since the publication of the final report has accentuated the difference between Heathrow and all our other airports. A simple piece of evidence to point to on that is the different passenger number performance. If you look at Heathrow at the peak or the trough we were down 1.5 per cent and through 2010 passenger numbers growing, on Heathrow terms anyway, rather strongly. All of our other airports, all of the point-to-point airports on the other hand, had double digit and larger declines and in many cases the decline is continuing right through to today.

and 'In the economic decline the demand came down and we anticipate, and I think most forecasters anticipate, that that demand will return with the growth in the economy.'

87. BAA said that there was no meaningful relationship between the growth in LCC capacity and economic growth across European countries. To back this up, it provided us with an analysis which looked at the growth in seat capacity offered by Ryanair and easyJet between summer 2008 and summer 2010 in each of the ten largest LCC markets (defined by the combined weekly capacity offered by Ryanair and easyJet), set against the economic growth in those countries over the corresponding period. It said that the analysis revealed no evidence of a meaningful relationship between the growth in LCC capacity and economic growth across European countries. BAA said that the two countries with the most significant growth in LCC seat capacity in absolute terms (Spain and Italy) had experienced among the worst economic conditions since the end of 2008. In contrast, the UK economy had performed more strongly over the relevant period than either Italy or Spain but had experienced a reduction in the seat capacity offered by Ryanair and easyJet.

88. BAA said that the UK low-cost market had probably reached the point of saturation and so it was natural for LCCs to look to other geographic markets to seek out profitability. Ryanair disagreed; it said that it had made repeated attempts to negotiate with BAA, so as to achieve substantial growth in Stansted's passenger traffic, and that it could very substantially increase its passenger numbers at Stansted (and it showed us some correspondence involving Ryanair and BAA on this subject from 2009).⁴⁶ This was following a 2007 rise in charges for Ryanair at Stansted once a previous agreement on charges had ended; Ryanair said that the passenger charge had increased from £5 to over £11 per departing passenger.⁴⁷ BAA also said that the business models of both airlines and airports against which Stansted was competing had changed; that there was a more aggressive appetite for LCC traffic. On the other hand, both Ryanair and easyJet told us that a substantial London presence remained central to their business cases.
89. Unite said that for point-to-point flights each airport catered primarily for its own local community and those in other areas who could not obtain a flight to their desired destination from any airport closer to home. It said: 'There are 39 miles between Heathrow and Gatwick by road and 72 miles between Gatwick and Stansted resulting in a significant additional road journey in order to utilise the services of a rival airport.'⁴⁸ Our assessment of customer overlap was set out in the 2009 report.
90. We looked at whether the reduction was, as BAA proposed, evidence of the emergence of a new pan-European market for LCCs with a consequent constraint on Stansted from non-BAA airports across Europe.

⁴⁶Ryanair representation on BAA's submission, Annex 1, and summary of a hearing with Ryanair, paragraph 18.

⁴⁷Ryanair submission, p13.

⁴⁸Unite the union submission, paragraph 2.3.

91. In our view, BAA's principal argument can be summarized as being that new competition from non-BAA/European airports suggests a broader market. During the original inquiry, both BAA and CAA put forward a similar line when discussing the constraint from distant airports.
92. The CC did not define rigid geographic markets but considered the impact of geographic differentiation on substitutability in the competitive effects analysis.⁴⁹ Chapter 3 and Appendices 3.1, 3.3 and 3.5 analysed substitutability of BAA airports in the South-East and considered substitutability from the perspective of both airlines and passengers. The evidence included catchment area analysis, passenger survey results, airline competitor analysis, airline views and switching analysis, and found that the BAA airports were the closest demand substitutes for one another.⁵⁰
93. In the report, the CC noted that any constraint from more distant airports is weaker than from airports that are considered to be substitutes by passengers, and acknowledged the growth of LCCs.⁵¹ The reasoning was given in paragraph 3.8:
- We consider that, due to the costs of establishing new routes, rivalry with more distant airports is less relevant when prices for existing services are being renegotiated. Once an airline has built up a profitable route, a threat to move to a distant airport with a completely different catchment area is less credible than a threat to move to a neighbouring airport with an overlapping catchment area.⁵² We therefore consider that any constraint from more distant airports is weaker than from airports that are considered to be substitutes by passengers.

⁴⁹Report, paragraph 3.1: 'we have not defined rigid geographic markets but decided to consider the impact of geographic differentiation on substitutability in our competitive effects analysis. In this section we set out our approach to assessing substitutability and our findings in relation to substitutability involving BAA's airports'.

⁵⁰Report, paragraph 3.168.

⁵¹Report, paragraph 3.10.

⁵²For example, Ryanair told us that the importance of the London area to its network was such that it had to serve that market, and had therefore to operate from BAA's airports to do so. We recognize that this is an extreme example as it relates to London but consider that it nonetheless illustrates the importance of neighbouring airports as substitutes for airlines with established routes in a particular geographical area.

94. The Stansted Q5 report also considered the constraint from European airports and found this to be a weak constraint. The reasoning was given in paragraph 3.11:

We were also not convinced that Continental European airports were a significant constraint on Stansted. Whilst an increase in charges at Stansted compared with charges at these airports would affect the relative profitability of routes, it was difficult to see, if a particular route from a Continental European airport were profitable prior to a charge increase at Stansted, why it would not already be served. We concluded that airlines would only switch to this route if they had previously been constrained in the number of aircraft they could deploy and, therefore, other Continental European airports were likely to provide only a weak constraint on Stansted in Q5.

95. Since 2009, Ryanair and easyJet have expanded on the Continent. Ryanair told us that serving the London market was essential to its business and, given capacity constraints, the only airport from which it could serve this market was Stansted. easyJet told us that a substantial London presence remained central to its business case. easyJet also told us that the ability to switch planes to different airports reflected capital mobility rather than a real competitive constraint, but at the same time told us that its flexibility over fleet size was limited and that it did try to create a competitive tension between non-neighbouring airports.

96. We have considered the contrasting views put to us by BAA on the one hand and Ryanair and easyJet on the other. BAA's views on the relevant market were considered in the 2009 report and, with regard to Stansted, in the Stansted Q5 report where we concluded that BAA airports (at that time including Gatwick) were the closest demand substitutes for one another and other Continental European airports were likely to provide only a weak constraint on Stansted in Q5. In our view, there are

many possible reasons for the changes noted by BAA. From the new evidence, it is clear that both Ryanair and easyJet still see London as being central to their businesses and both operators have been unable to use the threat of switching to prevent a large rise in their airport charges. We noted BAA's analysis of LCC growth in Spain and Italy (see paragraph 86). However, BAA did not control for the many variables which could impact on seat capacity, and we did not think the analysis addressed the question of whether the recession was or was not one factor in this (about which we also noted what BAA said in an oral hearing, set out in paragraph 85), or helped us understand what caused the decline in traffic at Stansted. We did not think that the evidence showed that the constraint from more distant airports had significantly increased since the 2009 report, leading to a decline in traffic in Stansted.

97. Therefore, in our view, the evidence of what has happened since 2009 does not amount to evidence that there has been a significant change in the market or a change in the constraint imposed by more distant airports compared with the constraint from airports that are considered to be substitutes by passengers.

Enhanced buyer power

98. BAA also said that Stansted's two largest airline customers (Ryanair and easyJet) had a significant degree of buyer power as a result of their high share of overall traffic at the airport, and they were in a stronger position than passengers to constrain airports because they could credibly threaten to move some or all of their services to a rival airport; and buyer power had increased in recent years as the market share of Ryanair and easyJet at Stansted had grown from 83 to 89 per cent of passenger traffic since 2007.⁵³ It told us in an oral hearing that what had happened since 2009

⁵³BAA submission, paragraph 74.

was that the market power, which already existed, was evidenced by a threat to move planes elsewhere if an airline's proposed terms were not agreed.

99. We looked at the number of ATMs in the period 2008 to 2010—see Table 3. There has been a small increase in the combined market share of Ryanair and easyJet since 2009—in terms of passenger numbers, between 3 and 6 per cent (depending whether the starting point is 2007 or 2008) to nearly 90 per cent—and in our view this is not indicative of any significant change.

TABLE 3 Ryanair and easyJet market share at Stansted, 2007 to 2010

		2007	2008	2009	2010 YTD
PAX (mppa)	Ryanair	15.1	15.0	13.7	11.8
	easyJet	4.7	4.3	3.8	3.6
	Sub-total	19.8	19.3	17.5	15.4
	STN total	23.8	22.3	20.0	17.3
% pax	Ryanair	63.4	67.0	68.8	67.8
	easyJet	19.8	19.5	19.2	20.9
	Sub-total	83.2	86.5	87.9	88.7
ATMs ('000)	Ryanair	103.8	102.8	93.3	78.0
	easyJet	38.4	35.5	30.4	28.0
	Sub-total	142.2	138.3	123.7	106.0
	STN	181.0	166.5	145.9	124.1
% ATM	Ryanair	57.4	61.7	63.9	62.9
	easyJet	21.2	21.3	20.9	22.6
	Sub-total	78.6	83.0	84.8	85.5

Source: BAA.

Note: 2010 figures are for January–November 2010.

100. We do not think that the threat by Ryanair to move planes elsewhere was a clear indication of successful use of buyer power—Ryanair has not to date successfully used its strong position at Stansted to achieve the terms and conditions for use of the airport that it is seeking—or was something that represents an MCC since the report's publication.

Conclusion on the decline in traffic at Stansted

101. There has been a decline in traffic at Stansted since the publication of the 2009 report. We concluded that this is not indicative of a new or significantly enhanced constraint on Stansted from LCCs operating on a pan-European basis, as proposed by BAA. However, as noted in paragraph 69, the decline in traffic at Stansted has

significantly enhanced the possibility for greater competition between Heathrow and Stansted, based on spare capacity at Stansted.

Heathrow's position as a hub airport

BAA's submission

102. BAA said that Heathrow's position as a hub airport had strengthened in the time since the 2009 report, citing as evidence:
- (a) Heathrow having experienced the smallest decline in passenger traffic;
 - (b) switching of US flights from Gatwick to Heathrow and increasing the number of flights once at Heathrow;
 - (c) four pairs of slots released as a result of granting anti-trust immunity to BA and American Airlines allowing additional US services which will further strengthen Heathrow's hub position; and
 - (d) the reduction in bmi's operations at Heathrow allowing Lufthansa and Star alliance partners to strengthen their network of services.⁵⁴
103. It said that the extent to which Heathrow and Stansted were effective substitutes for each other had materially reduced. It said that 'The recession has accelerated these recent developments and demonstrated the extent to which Heathrow and Stansted operate in separate economic markets' (see paragraphs 80 to 87 of the BAA submission). It said that the proportion of passengers at Heathrow that changed planes had increased from 34 to 38 per cent; in an oral hearing it subsequently said that the most up-to-date proportion of transferring passengers was 36 per cent. BAA confirmed that it did not regard the movements in this relative percentage as an MCC.
104. More generally, BAA said that Heathrow was in competition with other hub airports whilst Gatwick and Stansted competed with other point-to-point airports, and that

⁵⁴BAA also told us that the value of slots at Heathrow was £25 million, whereas at other airports it was zero, and said that if these slots were in the same marketplace they would presumably have the same value.

Heathrow was in a separate market from Gatwick and Stansted. It noted in this respect that Gatwick told us that Heathrow's traffic had been 'much more robust' than traffic at Gatwick, Stansted and Manchester,⁵⁵ echoing BAA's point set out in paragraph 100(a), and BAA said that this reinforced its point that Heathrow and Stansted operated in distinct markets.

Our analysis

105. BAA put forward the argument that Heathrow competed with different airports from Gatwick and Stansted, and was therefore in a separate market from them, during the original investigation. We considered this at the time but did not agree with BAA. The question for present purposes is whether Heathrow's hub status has changed materially since the 2009 report's publication.^{56,57}

106. The fact that passenger numbers have fallen least at Heathrow and traffic there has grown again, compared with the continuing decline at Stansted (see paragraph 100(a)), is not evidence of a weaker competitive constraint between two airports. There are many possible factors causing or contributing to this. For example: BAA's decision to raise prices for Ryanair at Stansted in 2007 and Ryanair's subsequent reduction in use of Stansted; Heathrow's position as a hub status causing it to attract a greater proportion of travellers who continue to travel during a recession (such as business passengers); Stansted's current reliance on LCCs, with fewer business customers and a greater reliance on customers whose travel might be discretionary; Heathrow having excess demand for slots (when demand declines, traffic may be expected to decline least where there is greatest excess demand); and BAA having a

⁵⁵Submission from Gatwick, p4.

⁵⁶We also noted that LCCs can and do operate out of some hub airports (for example, in the USA, where Frontier Airlines operates at airports such as Denver International and New York La Guardia), though not Heathrow, suggesting that the line between hub airports and non-hub airports proposed by BAA is not clear.

⁵⁷In its February 2011 Draft Guidelines on the assessment of airport competition, the CAA said that the differences between LCCs and full service providers and charter carriers were not as clear as they used to be. It said, 'the boundaries between the various airline business models are becoming increasingly blurred, with "full service" carriers adopting pricing structures introduced by "low cost" carriers, and some "low cost" carriers offering additional "frills" such as loyalty programmes, assigned seats or fast track boarding. Charter carriers, on the other hand, also sell seat-only flights, whilst some no-frills carriers also sell accommodation through their websites.'

greater incentive to maximize profits at Heathrow than at Stansted (because, for example, Heathrow is the more important profit centre, Heathrow has a far higher cap on airport charges per passenger than Stansted, and BAA is aware that it may have to sell Stansted).

107. BAA said that evidence for the increased hub status was that 20 daily US flights had switched from Gatwick to Heathrow following the EU–US Open Skies agreement, and that some of the airlines involved had added further services to those routes since switching, increasing Heathrow’s hub status (see paragraph 100(b)).⁵⁸ We asked BAA for information on these switched services. BAA provided us with evidence regarding services to 11 destinations that were switched entirely from Gatwick to Heathrow (and one that switched some flights to one destination from Gatwick to Heathrow). Ten of the 12 services switched in March or May 2008, nearly a year before the completion of the original investigation. Only two switched after the publication of the 2009 report.⁵⁹ Moreover, its evidence showed increased frequency of flights on only two routes.⁶⁰ We did not consider this to be strong evidence of a material change since the 2009 report’s publication.

108. The release of four pairs of slots (paragraph 100(c)) was in our view insignificant, bearing in mind there are over 9,000 slots per week at Heathrow. Finally, BAA mentioned the reduction in bmi’s operation by 150 flights per week over a three-year period (much of which was during the original investigation), referred to in paragraph 100(d). We did not consider this to be significant—a change over three years in who utilizes around 150 slots per week at Heathrow, which was already a hub airport,

⁵⁸Paragraph 80(b) and (c) of the BAA submission.

⁵⁹British Airways to Atlanta and Continental Airlines to Cleveland.

⁶⁰Continental Airlines to New York and American Airlines to Dallas/Fort Worth. In addition, there were a further two routes where the number of flights from Gatwick decreased from 2007 to 2008 and when the service was switched to Heathrow the flight frequency increased back up to 2007 levels (Delta/Northwest to New York and Continental Airlines to Houston).

does not in our view offer the prospects of a significant change in the strength of Heathrow's hub status.

109. In paragraph 83 of the BAA submission, BAA noted that no passenger airlines operated at both Heathrow and Stansted. We asked BAA if this was a significant change since the publication of the 2009 report. BAA told us that it was not. However, it said that the fact that no airlines operated at both Heathrow and Stansted was relevant to assessing the scope for competition between Heathrow and Stansted in current circumstances. Given the MCCs that it said had occurred in the market, it was counterintuitive, if competition were to exist, that airlines had not shifted capacity from Heathrow to Stansted in response to significant relative price increases at Heathrow and the relative availability of capacity at Stansted. We noted that this was not a significant change since the 2009 report and that, given that Heathrow and Stansted are currently under common ownership, it is hard to draw conclusions about the scope for competition between them by looking at what currently happens at the two airports.

Has Heathrow's hub status changed materially?

110. These factors are consistent with Heathrow being a hub airport—but we recognized that in the 2009 report (see, for example, paragraph 1(a) of the 2009 report). In our view, the fact that Heathrow and Stansted are differentiated in terms of airlines could be, at least in part, because of policies resulting from common ownership of the two airports. In this respect we noted, and agreed with, Ryanair's comment: 'The very fact that BAA owns both Heathrow and Stansted Airports means that it has no incentive for the two to compete. Separate ownership would, even with no capacity increase at all, enable the two airports to be managed to promote competitive

rivalry.⁶¹ Our view is that BAA's analysis suggests that the proportion of airline customers using Heathrow as a hub has not changed significantly, a view accepted by BAA (see paragraph 101).

111. Overall, our analysis of the evidence put to us about the strengthening of Heathrow's hub status led us to conclude that whilst Heathrow remains a hub airport, it has not materially strengthened its hub status.

Has the constraint from Heathrow materially weakened?

112. BAA's position is that Heathrow and Stansted are not competing with each other. Given the difficulty in airlines switching between airports noted in the 2009 report (Appendix 10.1, paragraph 40), switching by passengers is central to substitutability between airports. BAA said that there was not much it could do to incentivize a passenger to choose one airport over another. The evidence in the 2009 report (which included survey data and evidence from BA) was that many non-transfer passengers did view Heathrow and Stansted as substitutes. BAA, in its written evidence, simply disagrees with our 2009 assessment.
113. BAA's assessment works on a presumption that there is no substitution across airlines (or far less than there was) by customers—in effect, that customers currently using airlines operating out of Heathrow would simply never switch to an LCC airline. In light of the analysis conducted in the original investigation, and evidence received from BAA since then, this does not seem a realistic proposition to us:
- (a) In the 2009 report we found that although most airlines currently using Heathrow and Stansted would not view the other as a close or effective substitute, a significant number of their non-transfer passengers did.⁶² Airlines operating at Stansted considered that their most important competitors were located at

⁶¹Ryanair submission, paragraph 9.

⁶²Paragraph 10.47 and Appendix 10.1, paragraph 38, of the 2009 report.

Gatwick, closely followed by Heathrow.⁶³ And for passengers terminating at Heathrow, Heathrow's closest substitute was Gatwick, followed by Stansted and Luton.⁶⁴ We saw no reason for this to have changed since 2009.

(b) During the market investigation, we found that network airlines operating from Heathrow competed for short-haul passengers with LCCs operating from airports such as Stansted.⁶⁵ The evidence we received on this did not make us think that this had changed since 2009 either.

(c) In an oral hearing in January 2011, BAA described competition for customers to a destination as involving airlines with different business models and operating at different airports competing to win the same customers.⁶⁶

Conclusion on Heathrow's hub status

114. There has not been a significant change in Heathrow's position as a hub airport since 2009 (see paragraph 108). Moreover, for the reasons set out in paragraphs 110 and 111, we did not find that Heathrow was exerting, or had the scope to exert, a significantly reduced constraint on Stansted.

The fall in Stansted's profitability

115. The fourth MCC put forward by BAA was that there had been a significant fall in Stansted's current and forecast profitability. BAA has not proposed that this factor

⁶³Paragraph 3.162 of the 2009 report.

⁶⁴Paragraph 3.156 of the 2009 report.

⁶⁵Paragraph 3.132 of the 2009 report.

⁶⁶'I think the airlines are competing. There are some destinations: Geneva. You can fly to Geneva from Luton, Stansted, Gatwick or Heathrow. The difference in price of a ticket is probably smaller than the difference in your transport costs from where you live to whichever of the different airports, and I think the complication is that in order to understand the profitability of an aircraft in total you have to look at every single passenger. The fact that those airlines can offer you very competitive prices between the two—and if you look at the same day on the same route, London to Geneva, you will find broadly similar prices—that does not mean the profitability model of British Airways is flying, say, as a network, and the low-cost is the same, or that the average price of the tickets are the same, because it is not. Our competition is quite clearly with airlines to put on routes and then the airlines compete with each other to win passengers to their one model or the other.'

should result in Stansted not being divested; its focus on this point relates to when Stansted should be divested and how long it should be given to effect divestiture.⁶⁷

Conclusion on impact of changes since the 2009 report

116. We have considered individually the changes since 2009 that BAA submitted to us, and found only one—the change in government policy regarding new runways in the South-East—that appears to have been a significant development since the 2009 report (see paragraph 73). We do not accept that there have been any significant changes relating to the competitive pressures on Stansted from non-BAA airports, or that the potential constraint from Heathrow, if it were under separate ownership, has diminished.

Is there an MCC such that Stansted should not be divested?

117. We considered whether, in light of the change in government policy, the divestment of Stansted remained effective and proportionate. In doing so, we had regard to the need that the divestment:

- (a) must be effective to achieve the legitimate aim in question (appropriate);
- (b) must be no more onerous than is required to achieve that aim (necessary);
- (c) must be the least onerous, if there is a choice of equally effective measures; and
- (d) in any event must not produce adverse effects which are disproportionate to the aim pursued.⁶⁸

118. We also considered whether, taking all of the market developments put to us by BAA together, the answer would be different from what it would be if we looked only at the impact of the change in government policy. As explained in paragraph 114, we

⁶⁷BAA noted that our assessment of proportionality did not take account of the impact on shareholders of one-off costs associated with divestment, but said that it did allow for consideration of the balance between factors favouring rapid disposal and factors proposing a slower divestiture.

⁶⁸These principles were established in the FEDESA case. This particular formulation was the summary of these principles set out in the CAT's Tesco judgment, paragraph 137.

thought that the change in government policy was the only significant change. Nevertheless, we considered all the changes together. We found that we reached the same answer on whether the divestment of Stansted remained effective and proportionate looking at all the changes together as we did when we looked at the impact of the change in government policy alone.

Is the remedy effective to achieve the legitimate aim in question?

119. We considered whether divestment would be effective in paragraph 10.16 (which cross-referred to paragraphs 10.119 to 10.197) of the 2009 report. In doing so, we had regard to the purpose of divesting Stansted, which—as set out in paragraphs 36 to 39—is to address the AECs of common ownership as they relate to Stansted and its interaction with Gatwick and Heathrow.
120. Our guidance on market investigations⁶⁹ sets out, in paragraphs 4.13 to 4.17, factors which bear on the effectiveness of remedies. We considered whether, given the change in government policy, the divestment of Stansted remained an effective remedy. First, the remedy is clear to the persons to whom it is directed and also to other relevant interested parties. Secondly, as the remedy can be imposed by Order it is clear that the remedy can be implemented and complied with. Moreover, as it is a structural remedy, it will not require costly monitoring and compliance programmes. As noted in paragraph 4.15, an advantage of one-off remedies is that they address the competition concern directly and will require comparatively little, if any, monitoring or enforcement of compliance. And thirdly, the remedy can be expected to have effects within a short timespan, as the conditions for encouraging competition would be put in place as soon as divestment occurred. We also considered additional factors which we considered relevant. We noted that the divestment of Stansted

⁶⁹Market Investigation References: Competition Commission Guidelines, June 2003: www.competition-commission.org.uk/rep_pub/rules_and_guide/pdf/cc3.pdf.

raises no issues of compatibility with other legislation applying to BAA, and that the divestment is part of a wider package which has a shared aim of introducing competition into the provision of airport services in the South-East; as such, we expect the divestment of Stansted to be mutually reinforcing with the other parts of the remedy package set out in the 2009 report.

121. The requirement to divest Stansted offers a clear, easily implemented and timely way of addressing the AEC of common ownership of Stansted and Heathrow airports.
122. Divestment of Stansted is therefore effective in remedying the AECs relating to common ownership in south-east England, by removing the common ownership of airports in the South-East. It follows from this that we do not accept BAA's arguments that the change in government policy invalidates the effectiveness of the remedy (see paragraph 32).

Is the remedy no more onerous than is required to achieve that aim?

123. The remedy package was designed so as to be no more onerous than necessary to meet its aim. For example, we did not require the divestment of Heathrow, allowing BAA to divest Gatwick and Stansted instead (see paragraph 10.35 of the 2009 report), and we did not require simultaneous divestments even though that would have resulted in the detriment being remedied more quickly than sequential divestments (see paragraph 10.181 of the 2009 report). We consider afresh the question of simultaneous divestments, the order of divestment and the timescale for divestment later in this report. In light of that analysis finding no reasons to change these elements of the remedy (indeed it finds less reason to rule out simultaneous divestment than we found in 2009), we are confident that, if it is appropriate to require divestment of Stansted, all elements of the Stansted divestment as set out in the 2009 report remain necessary.

Is the remedy the least onerous, if there is a choice of equally effective measures?

124. The BAA submission noted that ‘given the significant reduction in benefits associated with separation of ownership of Heathrow and Stansted, the CC would need to explore whether alternative remedies would be more proportionate in current circumstances’ (paragraph 115). BAA proposed that ‘the CC should consider whether the separation of control between Heathrow and Stansted, as opposed to separation of ownership, would be a more proportionate remedy’ (paragraph 116). Appendix 11 to BAA’s submission outlined a package of ‘hold separate’ measures which it said would deliver effective separation of control, and cited the example of BT and Openreach⁷⁰ as a suitable precedent for such an arrangement. The measures included:

- (a) separation of board and management from the rest of BAA and inclusion of an independent trustee as a non-executive member of the board;
- (b) separation of Stansted Airport Limited functions for finance, strategy, regulation, communications and public affairs, operations, commercial, IT, HR and procurement from those of Heathrow Airport Limited;
- (c) ‘logical separation’ of IT systems; and
- (d) changes to culture, incentives etc.

125. We note that under these arrangements BAA proposed to retain responsibility for the composition of the Stansted board and setting capital expenditure and budgets. In addition, Stansted would remain within the ‘Designated Security Group’ with Heathrow as part of BAA’s financing structure and would share its financing function at a BAA board level including Treasury and tax functions (footnote 2 of Appendix 11 of BAA submission). Although IT systems would be ‘logically separated’, they would not be physically separated ‘until a later date’.

⁷⁰Undertakings given to Ofcom by BT pursuant to the Enterprise Act 2002, 22 September 2005.

126. In response to BAA's submission on alternative measures to divestiture, first, we do not share BAA's view that the balance of benefits and costs with regard to divestiture has changed so as to render divestiture disproportionate, and our views on this are set out in paragraphs 128 to 148 and Appendix A.
127. Secondly, in the 2009 report we considered alternative remedies proposed by BAA including management and/or financial separation (see paragraphs 10.19 to 10.25 and Appendix 10.1, paragraphs 59 to 64, of the 2009 report) but concluded that only divestment would be effective. In particular, in paragraph 10.24 of the report we stated that 'We consider that the incentives for innovation and rivalry generated by such separation will be relatively weak unless there is full separation of ownership. Enforcement of such separation may also be an onerous regulatory requirement.' The design of the proposals outlined in Appendix 11 of the BAA submission does not change our view of such arrangements although the proposal is more detailed than submissions provided prior to publication of the 2009 report. On the contrary, the more detailed design now provided by BAA demonstrates the substantial linkages that would remain with BAA, as noted in paragraph 123. In our view, it is still the case that managerial and/or financial separation will not address the AEC effectively, whereas we would expect that structural separation would do so.
128. Thirdly, we consider that the example of BT and Openreach is not an instructive precedent with regard to this case. Both the industry and the facts of the case differ significantly. The circumstances of the Openreach case are not analogous to BAA as these involve providing competitive market access to a vertically integrated network facility, whereas our investigation is into businesses at the same level of the supply chain which under separate ownership would be able to compete with one another. Although the Openreach example exists, we cannot comment on how effectively

these measures operate in practice and how these might apply to the circumstances of BAA.

129. We conclude that the alternative remedy put forward by BAA would not be substantially effective, or indeed close to being substantially effective, in remedying the AECs related to common ownership. More generally, we found in paragraph 10.29 of the 2009 report that measures other than divestiture are unlikely to be substantially effective in the circumstances of this case and therefore we do not consider that they are a suitable alternative to divestiture of Stansted.

Does the remedy produce adverse effects which are disproportionate to the aim pursued?

130. We considered whether it was proportionate to require the divestment of Stansted in light of the change in government policy regarding new runway capacity in the South-East. For the purposes of this assessment, we took no account of the benefits of the remedy package that relate to the development of new runway capacity or competition based upon new runway capacity.⁷¹ Our analysis is set out in Appendix A. We summarize our findings below.
131. In the 2009 report, we estimated the costs of divestiture to be £23 million. As set out in paragraphs 3 to 7 of Appendix A, we saw no evidence to suggest that they had increased.
132. The 2009 report⁷² also expressed the costs of divestiture on a per-passenger basis in order to provide context for the level of net benefits that would need to occur as a

⁷¹We note for completeness that there is a new benefit that would accrue if we did take account of benefits arising from new runway capacity. In Appendix 10.1, paragraph 32, of the 2009 report we said: 'we accept that government policy in relation to the next round of runway capacity expansion has already been developed and therefore that it may be too late for the divestiture of Gatwick to bring any benefits to the decision-making process in relation to the next tranche of runway capacity'. This is clearly no longer the case. So whilst the benefits of competition based on the development and operation of new runway capacity may now be more distant, there is now an extra benefit that would accrue at that time.

⁷²Appendix 10.3, Table 3, of the 2009 report.

result of divestiture to offset the costs of divestiture (the net benefits of competition are net of any relevant customer benefits that would arise from continuing common ownership). In paragraph 10.109 of the 2009 report we found that 'on average the net benefits of competition for the London airports would only need to exceed between 2p and 9p per passenger at Stansted or between 2p and 7p per passenger at Gatwick on average over the next 30 years to exceed our estimate of the maximum relevant costs of divestiture'. These calculations were based on one-off costs of divestiture of approximately £28 million at Gatwick and approximately £23 million at Stansted, and the benefits were shown net of any relevant customer benefits that would arise from continuing common ownership. The calculations were set out in Appendix 10.3 of the 2009 report.

133. The fall in passenger numbers at Stansted affects the calculation of the estimate of cost per passenger. We updated this analysis using BAA's estimates for Stansted passenger numbers in the period 2010 to 2014 (see Appendix A, paragraphs 7 and 8 and Table 2) and found that the net benefits of competition would only need to exceed between 2p and 12p per passenger at Stansted on average over the next 30 years to exceed our estimate of the maximum relevant costs of divestiture. The upper end of this range is equivalent to less than [X] per cent of Stansted aeronautical revenue and [X] per cent of operating expenses in 2010/11. In our view, the costs of divestment are very small in comparison to the size of the operation at Stansted.
134. As noted in Appendix A, paragraphs 9 to 12, £23 million may be at the top end of the likely range of relevant divestiture costs for Stansted. This is because most of this cost relates to IT separation, and BAA is making changes to its IT systems, irrespective of the proposed divestitures, with the purpose of separating IT systems at the airport level and minimizing the dependency upon a central and shared IT infrastructure. This may have the effect of making it easier and less costly to separ-

ate airports to be sold. However, we have not investigated BAA's IT changes in detail and we did not assume that the divestment costs would be lower than £23 million for the purposes of our analysis.

135. In the 2009 report, we said that we were unable to quantify the benefits of the divestment of Stansted and Gatwick (see paragraph 10.109 of the 2009 report). We concluded that we do not need to try and conduct such an exercise now as, in our view, for the reasons set out below we believe that the benefits of divestment significantly exceed the costs. We also noted that as well as having limited scope for useful outputs, attempting to quantify the benefits of divestment of Stansted would be a very resource-intensive exercise.
136. We looked at the various benefits that would flow from independent ownership of Stansted.
137. We noted that Stansted has a significantly greater level of spare runway capacity than it did at the time of the 2009 report, and Gatwick told us that it saw scope for significantly increasing the number of passengers using the airport through better use of existing runway capacity (see paragraph 61).⁷³ This suggests that the scope for competition based on spare runway capacity within existing constraints between Gatwick, Stansted and Heathrow has increased. As noted in paragraph 71, it is clear that there could be significantly more competition for customers and airlines between Heathrow and Stansted under separate ownership without new runways being built than we envisaged in 2009. In our judgement, this increased scope for competition is an additional aspect of the benefit of divesting Stansted.

⁷³We also noted that applying BAA's forecast passenger per ATM figures for 2020 to the level of ATMs in 2007 suggests that Heathrow could accommodate an additional 20 million passengers (see paragraph 6.12 of the provisional findings, published 20 August 2008). However, we saw this as more speculative than the excess capacity already seen at Stansted and the scope for extra capacity set out by Gatwick.

138. In Appendix A, paragraphs 13 to 40, we looked at some other benefits of divestment. We summarize our findings in paragraphs 137 to 146.
139. In paragraphs 19 to 23 of Appendix A, we looked at service quality improvement. In Appendix 5.1, paragraph 19, of the 2009 report we identified that competition on service quality would deliver benefits to customers. We found that there is evidence that, since it came under separate ownership, Gatwick has taken action to improve the customer experience and encourage airlines to use Gatwick.
140. This evidence is encouraging, though we do not place great weight on it, as Gatwick has not been under separate ownership for very long. However, such actions are to be expected with different airports under separate ownership, and we would expect service quality benefits to continue to accrue at Gatwick and to arise at Stansted once it is independently owned. These benefits are difficult to quantify, but are likely to be large in relation to the small costs of divestiture.
141. In paragraphs 24 to 32 of Appendix A, we looked at capital expenditure efficiency savings. Given the change in government policy, we reviewed the capex plans excluding a new runway. Capital investment programmes at airports are very large (even excluding new runways), and even within the current regulatory framework management an airport operator has a margin of discretion over the timing and nature of capital expenditure within a quinquennium. Economic regulation of airports is intended to provide a substitute for competition between them; we would expect, and we saw evidence, that it is an imperfect substitute (paragraphs 28 and 29 of Appendix A) such that there is still scope for improvement in capital expenditure efficiency at each of regulated airports, even in the absence of new runway capacity. In our view, independent ownership would increase incentives to deliver more efficient outcomes.

142. We looked at what has happened since Gatwick came under separate ownership. Gatwick told us that it had inherited a capex programme, and told us how it had addressed the challenge of achieving efficiency savings (see paragraphs 30 and 31 of Appendix A). We considered that the initiatives that the new owner of Gatwick has taken with respect to the capital expenditure programme that it inherited from BAA provide tangible evidence that independent ownership can result in immediate benefits to airport users, including the possibility that changes to the capex programme might reduce costs and produce outcomes more closely aligned to the needs of customers than can be achieved under the existing regulatory regime with airports under common ownership. On this basis, we think that it is reasonable to expect that similar benefits would flow from independent ownership of Stansted.
143. In our judgement, independent ownership of Heathrow and Stansted would result in greater efficiency in capital expenditure over and above that resulting from the existing system of economic regulation. We think that independent ownership of Stansted would deliver the same, or greater, outputs from an equivalent or lower investment. We think this will result in benefits that are greater in magnitude than the net relevant cost of divestiture.
144. We looked at the scope for operating cost efficiency savings even within the existing economic regulation environment (see paragraphs 33 to 37 of Appendix A). In paragraph 10.110 of the 2009 report we identified potential benefits from reductions in operating costs at Stansted through reducing relative pay costs by at least 20 per cent and scope for reducing absenteeism and its related costs. Under conditions of competition that would stem from independent ownership of the London airports, the commercial pressures on airport operators to review expenditure and to reduce costs would increase. We note that BAA forecasts operating expenses to be £[redacted] million in 2010/11, and £[redacted] million over the Q5 period, compared with the upper end of the

estimate for the net relevant costs of divestiture, is equivalent to an annual cash flow of £2 million per year. Saving a small percentage of operating expenses would save more than the cost of divestment and it is our view that such benefits are likely to arise sooner and to a greater extent under independent ownership of Stansted.

145. We concluded that there is a realistic expectation that the independent ownership of Heathrow and Stansted will lead to further efficiency savings in operating costs, over and above that seen under the current system of economic regulation, to such an extent that it would deliver benefits that would individually exceed the net relevant cost of divestiture.
146. We looked at the scope for price competition even within the existing economic regulation environment—see paragraphs 39 and 40 of Appendix A. In paragraph 6 of Appendix 5.1 of the 2009 report, we identified ways in which the airports could compete on price within existing capacity constraints, for example using rebalancing charges to encourage use of off-peak capacity. Stansted's forecast aeronautical revenue for 2010/11 is £[redacted] million, based on 18.1 million passengers.⁷⁴ This is equivalent to £[redacted] per passenger, which is [redacted] the price cap of £6.31 per passenger. Our analysis, based on BAA's estimate of the yield per passenger and for passenger numbers at Stansted, indicates that the benefits per passenger would only need to exceed 12p per passenger to exceed the upper end of the estimate for the costs of divestiture (see paragraph 131), and could be achieved if there was a reduction in aeronautical revenues per passenger of less than 5 ([redacted]) per cent or more (ie from £[redacted] to £[redacted] in 2010/11) over 30 years. The increase in capacity that has occurred since the 2009 report suggests to us that the scope for, and likelihood of, price competition under independent ownership of airports has increased. We con-

⁷⁴BAA submission, Appendix 10 (2007/08 prices).

cluded that there is a realistic expectation that price competition alone would deliver greater benefits than the cost of divestiture.

147. As noted in paragraph 38 of Appendix A, benefits would flow from comparative competition under economic regulation, with the CAA able to collect three sets of accounts produced by independent operators, allowing it to benchmark their performance. Stansted has a significantly greater level of spare runway capacity than it did at the time of the 2009 report (see paragraph 82), and Gatwick told us that it saw scope for significant runway capacity increases without a new runway (see paragraph 61). This suggests that the scope for competition based on spare runway capacity within existing constraints between Gatwick, Stansted and Heathrow has increased, resulting in larger benefits than at the time of the 2009 report.
148. We also considered that there were likely to be further benefits, which might accrue over the longer term and whose scale were more uncertain—see paragraphs 41 to 47 of Appendix A.
149. We think that the cost of divestiture is no larger and, as noted in paragraph 132, may be smaller than at the time of the 2009 report. We think that there are numerous benefits that are large, and that some of these benefits have increased in magnitude since the 2009 report. In our judgement, the combined magnitude of these benefits will significantly exceed the cost of the divestment. Although it is not possible to quantify each of the benefits, we think that even if some of these benefits did not accrue, taking combinations of only some of these benefits would still achieve levels of benefits that would exceed the cost of the divestment.
150. We conclude that the benefits of the divestiture remedy will be sustained over many years, and significantly exceed the cost of divestment, which is small and one-off in

nature. On this basis, we conclude that the divestiture of Stansted remains a proportionate remedy. It follows from this that we do not accept BAA's argument that the requirement to sell Stansted has been nullified by the change in government policy (see paragraph 32).

Conclusion on whether there is an MCC such that Stansted should not be divested

151. We conclude that the divestment of Stansted remains part of an effective and proportionate remedy to the AECs identified in the 2009 report. We also conclude that there are no MCCs or special reason such that we should not require divestment and we are therefore required by section 138 of the Act to take action under section 159 or section 161 in a manner which is consistent with the decision in the 2009 report (see paragraph 16).

Is there an MCC such that a Scottish airport should not be divested?

152. We also considered whether there was an MCC such that the decision for the divestment of a Scottish airport should be varied. BAA told us that its analysis about the constraint from LCCs on Stansted would apply equally to the Scottish airports, but it did not develop or substantiate this argument.⁷⁵ BAA told us that these had implications for the timing of divestment (we consider the timing and timescale for divestment later in this document), but that it did not have new arguments to make regarding the requirement to divest a Scottish airport. It did not, therefore, put forward any reasons why we should not require divestment of either Edinburgh or Glasgow. We found in paragraph 99 that the evidence relating to the constraint on Stansted from LCCs was not indicative of a new or significantly enhanced constraint and did not amount to an MCC. We consider that the same reasoning applies to Scottish airports. BAA did not propose, and we did not find, any other possible MCCs which might impact on the Scottish airports. We are content therefore that there are

⁷⁵See paragraphs 72 and 73 of the BAA submission.

no MCCs that change our decision to require the divestiture of Edinburgh or Glasgow, and we are therefore required by section 138 of the Act to take action under section 159 or section 161 in a manner which is consistent with the decision in the 2009 report (see paragraph 16).

Issues regarding details of the divestment process

153. In the 2009 report, we set out the following as regards the divestment of Stansted and a Scottish airport:
- (a) We permitted the sequential marketing of the divestiture airports (paragraph 10.181 of the 2009 report).
 - (b) The sale of Stansted should take place before the sale of a Scottish airport (paragraph 10.182 of the 2009 report).
 - (c) The sale of Stansted should be completed [X] after acceptance of undertakings or [X] after publication of the 2009 report, whichever was earlier (paragraph 10.183(b) of the 2009 report).
 - (d) The sale of Glasgow or Edinburgh should be initiated no later than [X] prior to the end of the period permitted for the divestiture of Stansted (paragraph 10.183(c) of the 2009 report).
 - (e) The sale of Glasgow or Edinburgh should be completed no later than [X] after the completion of the sale of Stansted (paragraph 10.183(d) of the 2009 report).
 - (f) BAA should complete the sale of Stansted no later than [X] and of either Edinburgh or Glasgow no later than [X]. The end date for all divestments was less than two years from the date of publication of the 2009 report.
154. We look here at the whether there are any reasons to change:
- (a) whether divestment should take place simultaneously or sequentially, subject to a degree of overlap;
 - (b) the order in which the airports should be divested; and

(c) how long should be given for each divestment to take place.

Simultaneous or sequential divestment

155. In the 2009 report we concluded that we would 'permit the sequential marketing of the divestiture airports. In its submission on MCCs, Ryanair raised the prospect of simultaneous divestments.⁷⁶ In response, BAA told us that Ryanair was incorrect to suggest that BAA's concerns about simultaneous divestments were now redundant because Gatwick had been sold, and that they in fact related to the requirement to market any airports at the same time.
156. We considered whether economic conditions generally, and market conditions for divestment, have changed since the 2009 report. We noted that economic conditions, whilst still fragile, have improved since the low point of the market in 2009.
157. Market conditions for divestment have clearly improved since 2009. Our analysis of current market conditions is set out in Appendix B. We summarize our findings here.
158. We found that debt market conditions have improved (see paragraphs 3 to 10 of Appendix B). There has been an improvement in the liquidity of the sterling corporate bond market since the publication of the 2009 report; the markets were open for corporate bond issuance throughout 2009; and both BAA and Gatwick Airport Ltd have issued corporate bonds, achieving terms that appear to be in line with those available to corporate issuers in the broader sterling investment grade debt market.
159. We also found that equity market conditions have improved (see paragraphs 11 to 16 of Appendix B). GIP has successfully completed the syndication of equity in Gatwick;

⁷⁶Representations by Ryanair Limited as to the remedies to be imposed on BAA Limited, paragraph 20, and summary of a hearing with Ryanair, paragraph 17. More generally, Ryanair told us that, given the different geographical markets and possible difference in the identities of potential purchasers, there was no reason to require that the divestitures should take place sequentially.

Ferrovial, the largest shareholder in BAA, is seeking interest for 10 per cent of its equity investment in BAA; and the performance of equities in the European airports sector indicates that the publication of the 2009 report coincided with a significantly lower point in the equity markets than is currently the case.

160. GIP told us that financial market conditions had improved since the final report. GIP said:⁷⁷

Despite these challenging times for airports, there seems to be no reasons [sic] why the benefits that separate ownership has already brought to passengers and airlines at Gatwick should not be seen by users of Stansted. We do not therefore see a case for changing the CC's remedy.

161. BAA said that 'if the prospects for generating focus and concentrated competition and competitive interest in buying one airport are limited, then selling two airports in parallel is even lower' [✂].

162. Whilst market conditions have improved, we did not think that they had done so to such a material extent that we should require simultaneous divestments. On balance, we thought that there remained a risk that requiring simultaneous divestment would create difficulty in selling both airports and achieving a fair value. In paragraph 10.179 of the 2009 report, we recognized that the simultaneous marketing of BAA airports might, in the then current market conditions, have constrained the opportunity to sell to a suitable purchaser and restrict prospective proceeds. We also noted that during the original investigation a potential bidder preferred sequential divestments, as it said that bidders might have a limited ability to mount effective bids simultaneously and capital availability in the current market was restricted.

⁷⁷Submission from Gatwick, p4.

163. We provisionally conclude that we should not change our decision set out in the 2009 report on sequential marketing of airports. We do not require the simultaneous marketing of the two airports. However, as set out in paragraphs 10.179 to 10.181 of the 2009 report, the marketing of one airport can overlap with preliminary preparations for the sale of another without impacting on the pool of purchasers or the prospective proceeds, and so we conclude, as we did in the 2009 report, that the divestiture periods of two airports should overlap by at least [X].

The sequencing of divestments

The BAA submission

164. BAA said:

The Report required the divestment of Stansted in advance of either Glasgow or Edinburgh. The CC's justification for this sequence (Report paragraph 10.183) was that:

- (a) Stansted was larger than either of the Scottish airports; and
- (b) the ownership of Stansted needed to be addressed to resolve the uncertainty around the G2 planning application to facilitate the development of new capacity as soon as it may be required.

165. It said that the planning-related reason no longer existed (by virtue of the change in government policy, the first of the proposed MCCs put forward by BAA—see paragraph 19(a)—and the fact that it has since consequently withdrawn its planning application for a second runway at Stansted) and hence there was no basis to require divestment of Stansted before a Scottish airport. It proposed that we would need to reassess the appropriate sequence in light of the changes that had occurred since the report, and that the CC could be significantly more confident of an effective divestiture process if it allowed Stansted to be divested after a Scottish airport; [X]. It also said that this would be a less disproportionate remedy than requiring the

divestment of Stansted first, given the other changes in circumstances it had identified relating to the prospects for new runway capacity and more limited scope for competition between Heathrow and Stansted within current constraints (the third proposed MCC—see paragraph 19(c)).⁷⁸

Our assessment

166. We looked at whether the reasons set out in paragraph 10.183 of the 2009 report remain valid.
167. We noted that there are more airport customers using Stansted than either Scottish airport. According to the CAA,⁷⁹ in 2009 19.95 million passengers used Stansted, compared with 9.04 million passengers using Edinburgh and 7.21 million passengers using Glasgow. Ryanair submitted: ‘More consumers would benefit sooner in the larger market of the South-East, and particularly if the divestiture of Stansted led to Gatwick behaving more competitively and addressing some of the other issues that were yet to be addressed.’⁸⁰ On the other hand, easyJet said that it believed the short-term gains of divestment would be greater in Scotland, where there was more scope for competition once the airports were under separate ownership.⁸¹
168. In our view, the change in government policy does reduce the strength of the second reason given in paragraph 10.182 of the 2009 report for divesting Stansted before a Scottish airport. In the short term we do not now expect it to be an important reason to require Stansted to be divested first.
169. However, as noted in paragraph 61, the decline in traffic at Stansted and Gatwick provides the conditions for greater price competition across all airports in the South-

⁷⁸BAA’s submissions on this point did not touch upon the second and fourth of its proposed MCCs, relating to a decline in Stansted traffic indicating a constraint from non-BAA airports across Europe, and a fall in Stansted’s profitability.

⁷⁹www.caa.co.uk/default.aspx?catid=80&pagetype=88&sglid=3&fld=2009Annual.

⁸⁰Summary of a hearing with Ryanair, paragraph 17.

⁸¹Summary of a hearing with easyJet, paragraph 20.

East, based on the spare runway capacity that is available, than was foreseen in the 2009 report. We would expect that the benefits of competition would be greater with Stansted and Heathrow under separate ownership, as economic theory suggests that common ownership itself will have affected the way in which BAA operates its airports. As set out in paragraphs 3.26, 5.20 and 5.30 of the report, we have observed no competition between BAA airports to date. As noted in paragraph 135, the enhanced scope for price competition is a factor in favour of the early divestment of Stansted.

170. BAA said that we would need to reassess the appropriate sequence of divestments in light of changes. In doing so, it said that we should also consider how the significantly reduced scope for competition between Heathrow and Stansted within current capacity constraints affected the previous conclusions on sequence of divestments (paragraph 121 of the BAA submission).
171. We considered whether the sequence of divestment should change because of any MCCs or special reason. We found that the evidence shows that there are still benefits from divesting Stansted first:
- As noted in paragraph 165, one of the reasons for the divestment sequence in the 2009 report was the relative scale and importance in addressing the AECs and detriments found. As noted in paragraph 165, Stansted remains the largest of the three airports.⁸² The airport market in the South-East of England remains larger than that in Scotland.
 - As noted in paragraph 166, the scale of the benefit associated with resolving the uncertainty around the G2 planning proposals has reduced. Short-term planning

⁸²We reach the same conclusion if we consider number of passengers, number of passenger ATMs, total revenue, EBITDA (pre-exceptionals), and net book value.

issues associated with the SG2 proposals are not an important reason in the short term to prioritize the divestment of Stansted.

- We have not found that the scope for competition between Heathrow and Stansted has reduced significantly (see paragraph 99).
- In fact the opposite is true. As noted in paragraph 167, there is now scope for greater price competition than that envisaged in the 2009 report across all airports in the South-East, based on the spare capacity that is available at Stansted and Gatwick. That competition would be more intense if Stansted and Heathrow were under separate ownership. Whilst there was always some scope for competition within existing runway capacity constraints, in our judgement there is now scope for significantly more, a factor in favour of the early divestment of Stansted.

172. We found that one of the reasons given in the 2009 report for divesting Stansted first remained, one was no longer important in the short term, and developments since the report mean that we also consider competition with existing runway capacity constraints to be a factor in favour of the early divestment of Stansted. We have therefore provisionally concluded that, in line with our conclusion in the 2009 report, Stansted should be divested first.

Divestment periods

Stansted

- *The BAA submission*

173. The BAA submission stated that there had been a material change in the commercial performance of Stansted (the fourth of BAA's proposed MCCs—see paragraph 19(d)) that merited an amendment to the start date and length of the divestiture period for Stansted. BAA also made a number of points about the Gatwick sales process.

174. BAA set out a number of reasons to delay the start of the sale of Stansted (paragraphs 122 to 130). These included:
- reduction in current profitability (paragraph 122);
 - expectations about future profitability (paragraph 122);
 - uncertainty about future growth prospects (paragraph 123);
 - [✂];
 - reduction in scope for competition between Heathrow and Stansted (paragraph 125);
 - [✂]; and
 - [✂]
175. BAA set out a number of reasons to extend the length of the Stansted sales process in paragraphs 132 to 150. To a large extent, these overlap with the reasons above, but BAA identified the following additional matters:
- partial recovery of financial market conditions (paragraph 133);
 - [✂]
 - narrower scope for competition between Heathrow and Stansted (paragraph 139);
and
 - [✂]
176. BAA set out its position in relation to the divestiture period to be:
- [✂], accompanied by interim separation measures (paragraph 138); and
 - [✂], in the absence of interim separation measures and if divested after a Scottish airport (paragraph 149).
177. BAA said that a delayed and extended divestiture period would have no material impact on consumers (paragraphs 128, 130 and 150) and would allow market conditions to recover (paragraphs 128, 136 and 150).

- *Our assessment*

178. We considered first the point BAA made about a delay in divestment having no material impact on consumers (see paragraph 175). It said (paragraph 150 of the BAA submission) that ‘given the MCCs, the additional time for the divestment of Stansted will not have a material impact on consumers’.
179. We disagreed with BAA. We identified significant AECs that impacted on consumers (see paragraphs 37 and 38). The AECs relate to common ownership, which can only be effectively remedied through divestment. We have found that divestment of Stansted remains an effective and proportionate way of addressing of AECs and resulting consumer detriment (paragraph 149), and thus we believe that delaying implementation by anything from one to four years would have an adverse impact on consumers.
180. We considered next the reasons to delay the start and extend the duration of the divestiture period relating to the commercial performance of the airport.⁸³
181. As noted above, [X]. However, as noted in paragraph 155, market conditions for divestment have clearly improved since 2009.
182. In addition, Unite said: ‘a forced sale [of Stansted] will cause the loss of the financial stability and other benefits associated with working as part of the world’s number one airport group in terms of revenue’ and ‘Should the sale of Stansted take place it is

⁸³Unite told us that ‘With such a rapid decline in passengers using the airport, it is only the strength that comes of being part of a large group, which has maintained the viability of the airport avoiding, to a very large degree, the need for wide spread job losses.’ (Unite submission, paragraph 2.6.) We noted its comments; however, the focus of our investigation is on the effects on competition.

possible that the airport might not be in a position to financially survive'.⁸⁴ We also noted Ryanair's comments about growth prospects at Stansted.⁸⁵

183. We considered the strength of Stansted's financial position. As noted in Appendix B, paragraph 17 and Table 5, the profitability of Stansted compares favourably with that of several European airports, with higher EBITDA and EBIT margins than Amsterdam Schipol and Aéroports de Paris in 2010, and higher margins than the forecast results for Frankfurt and Vienna. This indicated to us that, whilst it is still seeing a decline in passenger numbers, it is producing healthy financial results. High margins might in themselves reflect an absence of competition from Heathrow. Moreover, in our judgement a new owner would be free to make independent commercial decisions that may be different from those made by BAA, which also owns Heathrow, and Stansted's future operational and financial performance, including its growth (taking advantage of its new incentive to compete with Heathrow), would not necessarily be in line with BAA's projections.
184. We did not share Unite's concerns that selling Stansted would result in its loss of financial stability. In paragraph 10.142 of the 2009 report we set out the purchaser suitability criteria for the divestitures, which specified that a purchaser must demonstrate that it has appropriate financial resources and expertise to operate the airport. Appendix 10.5 of the report contained details of the information requirements for the Gatwick divestiture, and showed that potential purchasers would need to satisfy the CC that their financial structure could withstand adverse commercial developments. The CC will apply the same standard of review for each divestiture.
185. The aspects of BAA's submission that concern the commercial performance of Stansted appear to have a potential impact on the proceeds that it may be able to

⁸⁴Unite submission, paragraphs 3.7 and 3.8.

⁸⁵Ryanair submission, paragraph 22.

achieve rather than the effectiveness or proportionality of the remedy in addressing the AEC and detriments that we have identified.

186. We consider that the market value of Stansted will be established in a sales process. Potential purchasers would use a variety of valuation methodologies, and these would reflect the known information about the business, including both short-term and long-term prospects. The price that buyers are prepared to pay will therefore incorporate bidders' views on the performance that can be achieved by Stansted under new ownership. In our view, the market value of Stansted will already reflect the extent that BAA and/or potential purchasers expect that the value of Stansted will increase (or decrease) in the future.

187. In its judgment on the appeal bought by BAA against the 2009 report, the CAT⁸⁶ found that we did not 'dispute that the risk of such loss [risk of loss of value through timing issues] is a relevant factor of which account must be taken when considering the time-frame, and its proportionality' (paragraph 249), and the issue was whether the CC had properly weighed the factors in reaching its decision. In paragraph 255 of the judgment, the CAT referred to paragraph 10.179 of the 2009 report, saying:

There the Commission is clearly recognising and taking account of the risk of loss of value to BAA by indicating that concurrent sales will not be required to take place. The Commission is seeking to structure the divestiture in such a way as to avoid the risk in question, which the Commission considers will not arise in the event that there is merely some overlap in marketing one airport and making preliminary preparations for sale of another. Thus the Commission's policy in relation to loss of value caused by timing of divestiture appears to be to eliminate the risk altogether. That being so it would be surprising if the

⁸⁶www.catribunal.org.uk/files/1110_BAA_Judgment_21.12.09.pdf.

Commission had approached other aspects of the timing with a different aim, or had simply ignored the risk of loss of value. Nor would that be consistent with the Commission's description in paragraph 10.157 of the exercise which it states it is carrying out at this stage of the Report.

188. The CAT concluded in paragraph 256: 'Further, we are satisfied that the Commission took into account the risk of loss of value when fixing the stand-alone periods within which each of the airports were to be sold and also in the relationship of those periods to one another'. The start of paragraph 259 says: 'If the aim of the Commission was to eliminate as far as possible the risk of depleted proceeds, as we have found ...'.
189. The CAT concluded that we should take account of the loss of proceeds in designing the remedy package, and that we had indeed done so. BAA is effectively asking us to revisit that analysis on the basis that since the report the value of Stansted has decreased, increasing the risk of depleted proceeds if it is required to divest in the near future.
190. There is a tension in extending the divestment process between reducing the risk of depleted proceeds for shareholders on the one hand, and extending the duration of the consumer detriment arising from the AECs identified on the other hand. In the 2009 report, we found the appropriate balance through the choice of divestment period and use of sequential divestments (with a limited overlap). In our view, that remains the appropriate balance. Stansted's passenger numbers have decreased since the 2009 report's publication. On the other hand, having noted BAA's submissions that Stansted's profitability has declined since the 2009 report, we found that recent figures show it compares favourably with that of several European airports, and we were told that since 2009 investor appetite for assets such as airports has

increased.⁸⁷ And we found that market conditions for divestment have improved since 2009 (paragraph 155) (and general economic conditions have improved since the low point of the market in 2009—see paragraph 154). In the meantime, customers have felt, and continue to feel, substantial detriment from continued common ownership over this period.

191. The evidence we received from BAA suggested to us that [REDACTED].⁸⁸ The benefits of a delay in terms of reducing the risk of depleted proceeds appears, therefore, to be at the very least uncertain. On the other hand, in our view, there remains clear detriment that requires remedy. Given this, we thought that there should be no more concerns, and very probably fewer concerns, about loss of value for shareholders through timing of the sale process than there were in 2009. We therefore see no reason to amend the design of the remedy to accommodate the uncertain possibility that BAA could receive an increased price for Stansted in any reasonable time frame. That market conditions have improved since the 2009 report strongly reinforces that there is no need to extend the divestment period.
192. We also considered the points raised regarding the imposition of a tight deadline for conducting the sales process, and BAA's experiences of running the Gatwick sales process. BAA took 13 months to reach agreement for the sale of Gatwick to GIP, and this transaction completed two months later, after all regulatory approvals were received.⁸⁹ During the sales process there were periods in which there was no active discussion with bidders, and it is possible that BAA could have reached an agreement with the successful purchaser some months earlier without significant detriment to divestiture proceeds. In the sale of Gatwick, there also appeared to be major delays caused by issues of IT system separation which are likely to be much reduced

⁸⁷Summary of a hearing with Gatwick Airport and GIP, paragraph 47.

⁸⁸BAA told us that [REDACTED] and [REDACTED].

⁸⁹BAA told us the duration of other airports sales it had conducted, but said that every airport sale process faced different issues and the time taken to sell one airport may be different to the time required to sell another airport.

in the sale of Stansted or a Scottish airport, as lessons have been learnt from the first divestment, and BAA is undertaking an IT programme which looks likely to make separation easier.

193. We also consider that an effective divestiture process usually involves active engagement with potential bidders in a tightly defined time interval. We do not agree with BAA that the CC's purchaser approval processes have any detrimental effect on the ability of the vendor to achieve market value for its assets. The CC's standard divestiture period is six months, but in the 2009 report we specified [redacted]. We concluded at the time of the 2009 report that a period of [redacted] represented ample time to complete a divestment, and we did not identify MCCs that would merit a reduction or increase in this time frame.

194. We have not identified anything relating to the time taken to sell Gatwick that would lead to a conclusion that the time required to sell other airports should be increased from the [redacted] set out in the 2009 report. There is no reason to change how we define the starting point for the divestment period.

- *Conclusion on divestment period for Stansted*

195. In light of the above analysis, we provisionally found that there were no MCCs or special reason that would cause us to vary the divestment period for Stansted from a period of [redacted].

Divestment period for a Scottish airport

- *The BAA submission*

196. In paragraph 152, BAA states:

The potential for the CC's divestment process to distort the sale process also applies in relation to the divestment of either Glasgow or

Scotland. There is a risk that the potential for the CC's divestment process to distort a proper commercial negotiation, added to the weak market conditions referred to above, may compromise the effectiveness and proportionality of the remedy in Scotland.

197. In paragraph 153, BAA proposes that an [✂] period should be granted for the sale, compared with a [✂] period in the 2009 report.

- *Our assessment*

198. BAA's position on the divestment period for a Scottish airport is the same as one of the arguments it ran for the Stansted divestment period. We considered this, but did not accept it, in paragraphs 190 and 191. For the same reasons, we do not accept this argument here.

- *Conclusions on divestment period for a Scottish airport*

199. We provisionally conclude that there are no MCCs or special reason such that we should alter the divestment period for a Scottish airport.

Conclusions on the details of divestment

200. We found that there were no reasons for us to change: divestment taking place sequentially, subject to a degree of overlap; the order in which the airports should be divested; or how long should be given for each divestment to take place. We are therefore required by section 138 of the Act to take action under section 159 or section 161 in a manner which is consistent with the decision in the 2009 report (see paragraph 16).

201. Therefore, after taking account of the various factors considered above and consistent with our report, we have provisionally decided that:

- (a) The sequential marketing of the divestiture airports is permitted.
- (b) The sale of Stansted should take place first.
- (c) The sale of Stansted should be completed [X] after acceptance of undertakings or [X] after publication of the final version of this document, whichever is earlier.
- (d) The sale of Glasgow or Edinburgh should be initiated no later than [X] prior to the end of the period permitted for the divestiture of Stansted.
- (e) The sale of Glasgow or Edinburgh should be completed no later than [X] after the end of the period permitted for the divestiture of Stansted.
- (f) The divestment of the two airports should be completed within [X] of acceptance of undertakings⁹⁰ or [X] after publication of the final version of this document, whichever is earlier.

Conclusions

202. We invited submissions on whether there were any MCCs or special reasons such that we should amend in any way the remedies related to the divestment of Stansted and a Scottish airport. BAA set out what it said were four MCCs, which it said meant that we should not require the divestment of Stansted. If we were not persuaded of that, BAA said that we should amend the divestment sequence and allow longer divestment periods. No party suggested to us that there is any special reason other than an MCC for not implementing the remedies in the 2009 report.
203. We considered BAA's submissions. We found that the change in government policy, with the Coalition Government opposing the proposals for the third runway at Heathrow and SG2 at Stansted and opposing new runway development at Gatwick, was a significant development and meant that the delivery of new runway capacity, and the benefits of competition based on spare runway capacity, were likely to be at least delayed. We did not find that any of the other possible MCCs put to us by BAA

⁹⁰We have the option of agreeing undertakings or making an Order.

were significant developments since the 2009 report was published. However, we also found that since the 2009 report the scope for competition between airports within existing runway capacity has increased. Runway capacity at Stansted has been freed up, while Gatwick's new owners see scope for significant increases in passenger numbers through better use of slots and use of larger planes.

204. The remedy was put in place to address the AECs relating to common ownership, and we found that divestment of Stansted remained an effective way of addressing this. We considered a remedy proposed by BAA as an alternative to divestment. We concluded that the alternative remedy would not be substantially effective in remedying the AECs related to common ownership. As such, the divestment remedy package remained the only substantially effective way of remedying the AEC.
205. Given that the benefits of competition based on new runway capacity were likely to be at least delayed and may not accrue at all, because of the change of government policy, we reassessed the benefits of intervention relative to the costs, taking no account of any benefits associated with new runway capacity. We found that the benefits of the divestiture remedy significantly exceed the cost of divestment.
206. We conclude, therefore, that there are no MCCs or special reason that should lead us not to require the divestment of Stansted. We conclude that it remains appropriate to require the divestment of Stansted.
207. We also find that it remains appropriate to require the divestment of a Scottish airport.

208. We considered whether there were any MCCs or special reason to change the divestment sequence or lengthen the divestment periods set out in the 2009 report. We concluded that there were not.
209. We are therefore required by section 138 of the Act to take action under section 159 or section 161 in a manner which is consistent with the decision in the 2009 report (see paragraph 16).
210. We concluded that BAA should be required to divest Stansted within a period of [X] starting from the earlier of: the date on which undertakings are accepted from BAA; or three months after the date of the final version of this document. BAA is then required to initiate the sale of a Scottish airport no later than [X] prior to the end of the period for the divestiture of Stansted, and to complete the sale no later than [X] after the end of the period for the divestiture of Stansted. The overall time frame for the two divestments is no more than [X] after the acceptance of undertakings or [X] after publication of the final version of this document.