Competition & Markets Authority

BAA airports: Evaluation of the Competition Commission's 2009 market investigation remedies

16 May 2016

Acknowledgements:

This report has benefited from comments received from Eric Pels, Assistant Professor at VU University Amsterdam.

Contents

Page

1. Summary

The 2009 market investigation and the Competition Commission's interventions

1.1 In March 2009 the Competition Commission (CC) concluded its market investigation into BAA airports and found there was 'no competition' between the seven UK airports owned by BAA. At that time BAA's airports controlled 81% of London's runway capacity and serviced 62% of UK passengers.

1.2 Having identified substantial competition problems in relation to BAA airports the CC made several interventions designed to benefit passengers and airlines (the CC remedies). The most significant CC remedy required BAA to sell three airports. As a result of this remedy Gatwick, Edinburgh and Stansted airports have been under new ownership since 2009, 2012 and 2013 respectively. Airports sold by BAA as a result of the CC remedies together served 65 million passengers in 2008 and were valued at a total £3.8 billion on divestment. The CC's other remedies sought to address problems identified with the regulatory framework and government policy in place at the time, and the competitive position of BAA's airport in Aberdeen. New regulation for airports, which was influenced by the CC's recommendations, took full effect in 2014 in the form of the Civil Aviation Act 2012 (CAA12).

1.3 The purpose of this evaluation project has been to assess the initial impact of the CC's interventions and identify any lessons we can learn from the CC's remedies development and implementation process. Our research methodology incorporated qualitative evidence gathered from a range of stakeholders from across the industry, together with desk research and a quantitative assessment of consumer benefits to date, undertaken by independent consultants, ICF International (ICF).

1.4 Our evaluation covers a period during which, in addition to the CC remedies, many wider developments have taken place across the aviation sector. These include (i) the global financial crisis and the unusually turbulent subsequent economic climate, (ii) the longer term effects of 'open skies' agreements which deregulated airline operations during the period 1987 to 2007, (iii) airline consolidation/increased code-sharing alliances and (iv) the evolution of airline commercial models, such as the historic rise of the low-cost carriers (LCCs) including Ryanair and easyJet, and more recent convergence between LCCs and full service network carriers.

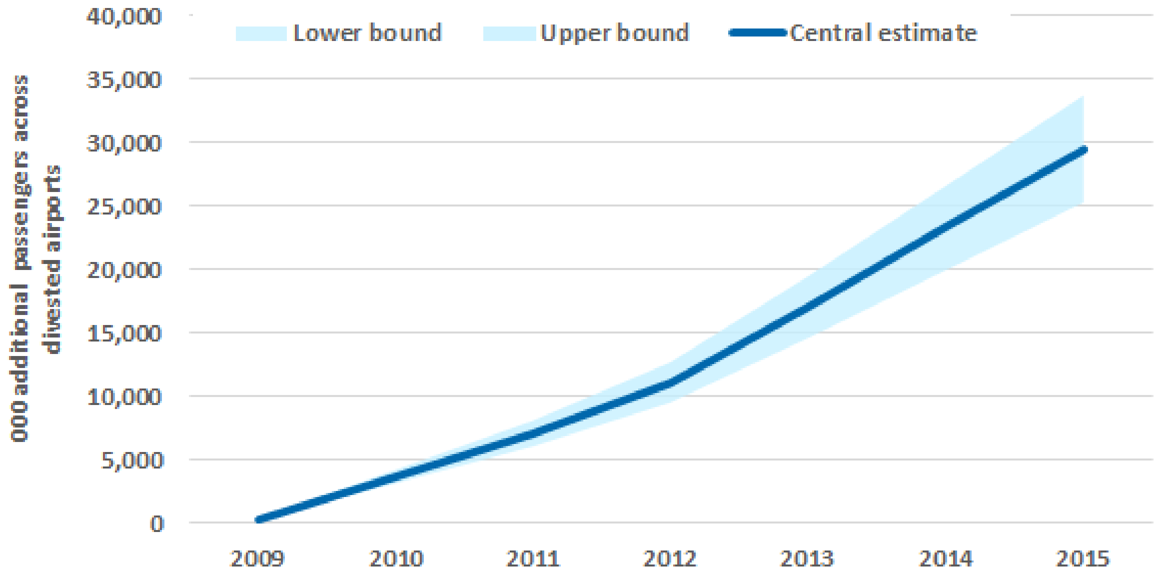
Benefits identified

1.5 While it is difficult to isolate with precision the full benefit across the range of the CC remedies, there is strong evidence of positive changes at divested airports. These changes result from a combination of new and separate ownership of airports and the more flexible regulatory framework now in place under CAA12. Benefits arising from the separate ownership of airports and those resulting from the new regulatory framework, which took effect alongside divestments, have interacted and reinforced each other. Stakeholders told us that many of these positive differences would not have arisen without CC intervention. Stakeholders also said that the CC's remedies were likely to have been an important catalyst for changes at BAA's airports not subject to divestment, including the UK's largest airport, Heathrow.

1.6 Positive changes derive primarily from new commercial strategies at divested airports and other airports directly and indirectly affected by the divestments. As well as increased focus on passenger experience, airports' revised strategies seek to build more productive relationships with airline customers in order to deliver benefits to passengers across key strategic and operational areas. A number of factors indicate increased competition and benefits to passengers:

(a) **Passenger growth**: Divested airports have delivered growth in passenger numbers at measurably higher levels post-divestment than other UK airports as shown in Figure 1.1. The higher passenger numbers at Gatwick, Stansted and Edinburgh indicated by ICF's analysis are measured after taking account of long-term trends which would otherwise explain changes in passenger numbers at airports, and factors related to the individual characteristics of airports analysed. Gatwick has increased its share of passengers travelling to and from London airports since divestment despite its capacity constraints, as has Stansted. Edinburgh's share in lowland Scotland has also increased. The increase in passenger numbers is likely to have created benefits to consumers in the form of improved connectivity and choice. As a result of these improvements in connectivity and choice more passengers are able to fly, including some that would not otherwise have done so. These passengers benefit directly from having taken those journeys. Second, expanding supply puts downward pressure on prices for air travel all else being equal. While wider development in the airports and aviation market make it difficult to establish a definite causal link between the CC's divestment remedies and the increase in passenger throughput, the weight and breadth of evidence clearly suggests that the CC's intervention was the main driver of the observed changes.

Figure 1.1: Estimated cumulative additional passengers at divested airports since divestment ('000)



Source: ICF analysis.

(b) **Efficiency**: Divested airports have increased the efficiency of their capital investment in facilities/services and improved their operational efficiency over time. Divestiture has enabled airports to make decisions locally and implement bespoke changes that are optimal for individual airports, switching service providers if necessary. There is greater focus on process improvements than historically, and particularly strong evidence of lower operational costs across a range of indicators at Gatwick. As a result of divestiture and the new regulatory framework in place airports' incentives to undertake large-scale capital expenditure (capex) without clear benefits to airport users appears to have diminished.

(c) **Service**: Service quality to passengers and airlines has improved markedly at Gatwick, the first airport that was sold. At the airports more recently under new ownership, improvements are expected at Stansted and Edinburgh as the investment in new terminal facilities now underway and new operational initiatives are fully embedded. Service quality at Heathrow, which also adopted new commercial strategies after divesting the airports required by the CC remedies, has reached a historic high. In 2015 passengers scored Heathrow's overall service quality above the average of the highest scoring European airports. This is a marked improvement from service scores achieved by Heathrow in 2008 when the airport ranked 97th out of 127 airports surveyed.

(d) **Route choice**: Efforts to attract additional airlines, routes and flight frequencies have increased as Gatwick, Edinburgh and Stansted have competed on the strength of their individual attractions to airlines and passengers rather than acting as part of the BAA group. Airports that previously focused on LCCs or short-haul flights because of BAA's segmentation of the market between its airports are now also competing for full service network carriers and long-haul international routes.

(e) **Level of airport charges**: Both Gatwick and Stansted have agreed long-term competitive deals for airport charges with their major customers. Some point-to-point airlines, particularly those that are not constrained by the configuration of existing network operations or large sunk costs at airport bases, have been able to negotiate lower airport charges. However, several stakeholders cited capacity constraints in the South-East as limiting options for airlines to switch airports and a consequent limitation of their negotiating power.

(f) **Structure of charges**: Airports have altered the structure of their charges to airlines in order to become more competitive and encourage more off-peak airport use, for example offering seasonal discounts and incentives to airlines to encourage the operation of larger, fuller aircraft.

(g) **More efficient use of existing capacity**: Restructured airport charges have attracted additional flights during quieter periods and increased the efficiency of aircraft utilisation. The introduction of rivalry has led to more efficient use of existing capacity, particularly at Gatwick. This has contributed to the observed increase in passenger throughput.

(h) **New capacity**: The CC considered that BAA's common ownership of the three major airports in the London area appeared to have exacerbated delays in the delivery of runway capacity and noted BAA's reluctance to press for more runway capacity. Under separate ownership competition for the allocation of new runway capacity has increased considerably. Information on expansion options provided to ministers has been comprehensive with detailed bids from Heathrow and Gatwick.

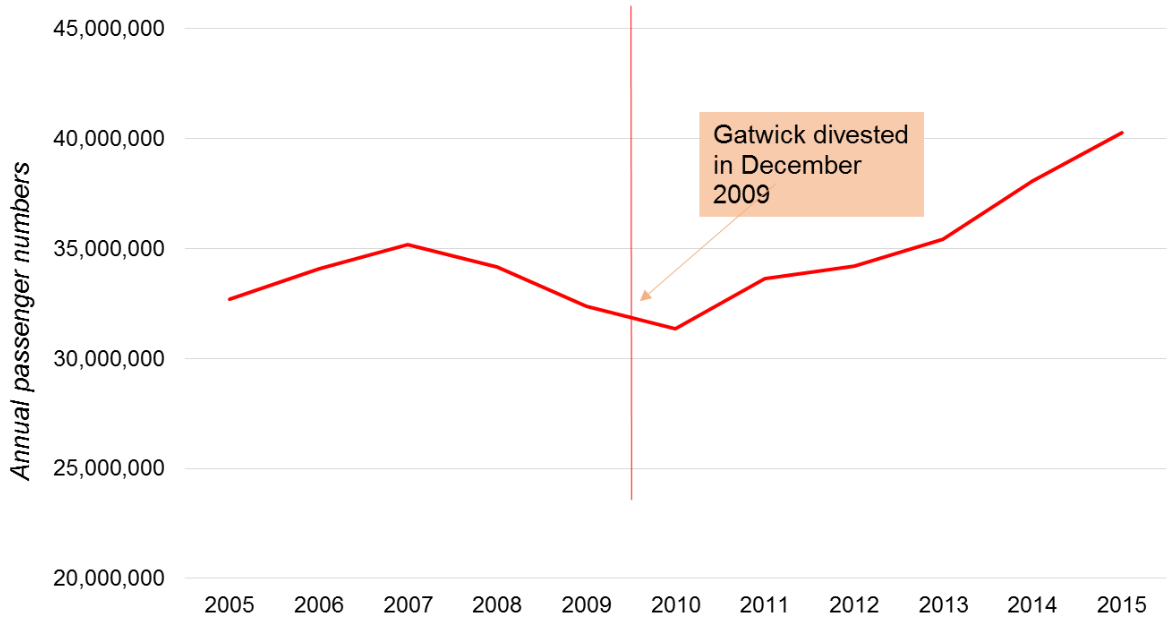
(i) **Airport community and stakeholder engagement**: Airports cite stronger relationships with, and more efficient use of, government resources at border control, and better engagement with local communities.

1.7 The extent and nature of change in the factors identified above varies by airport:

(a) **Gatwick**: The most significant level of change observed among divested airports has occurred at Gatwick. This may be expected as it is the largest of the three divested airports, and the airport that has benefited from the

longest period under separate ownership. Change at Gatwick has also been supported by lighter-touch regulation since early 2014. Improvements at Gatwick have been delivered despite operating at close to its capacity limit for aircraft movements (take-offs and landings) at peak times. Gatwick's revised commercial strategy has delivered widespread change encompassing its relationships and operational arrangements with airlines, efficiency improvements, capacity generation, innovation and better service quality. Despite capacity constraints passenger numbers at Gatwick have steadily increased since its divestment and Gatwick has also increased its share of passengers travelling from London airports by one percentage point. The trend in passenger numbers at Gatwick before and after divestment is shown in Figure 1.2.

Figure 1.2: Passenger volumes at Gatwick



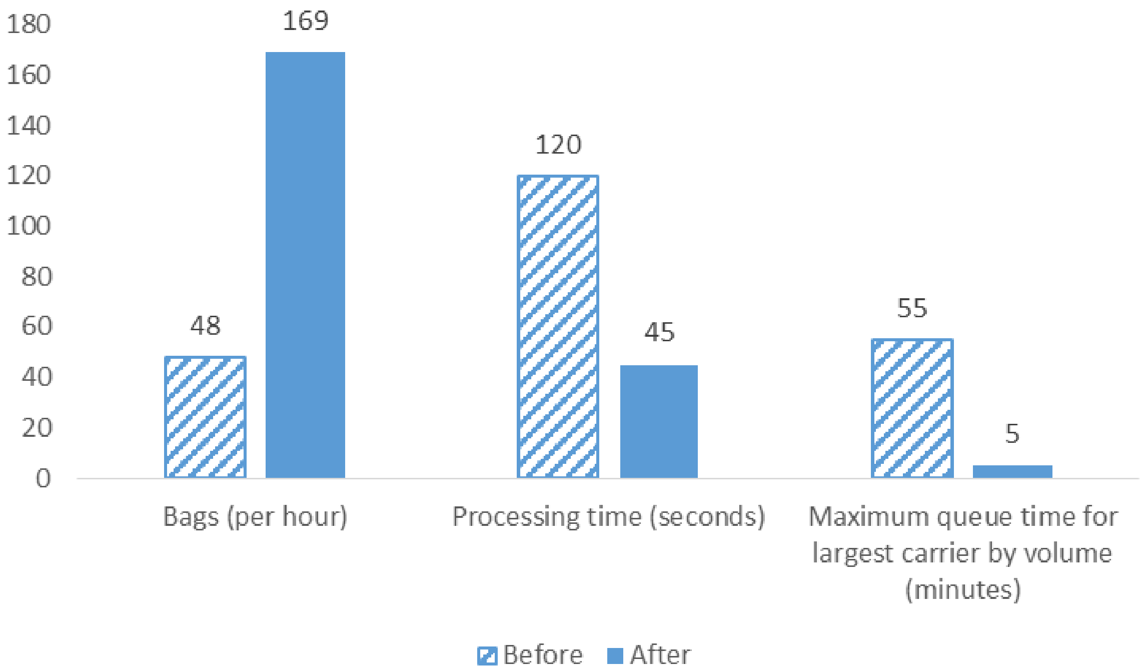
Source: CMA analysis of CAA terminal and transfer passenger data.

(a) **Stansted:** Stansted's new strategy targets growth from airlines outside its traditional LCC customer base and delivery of service improvements, as well as growth from existing carriers. Investment to improve the quality of services at Stansted has increased following a period under BAA ownership during which it only received routine maintenance spend. Stansted also provided examples of achieving significant savings in operational and capital expenditure compared with BAA's expenditure plans that it had inherited following divestment. A more diversified airline/destination offer is expected to enable Stansted to target passengers in its relatively affluent immediate local catchment area, which includes the fast-growing Cambridge to London corridor. Stansted's research indicates that two-thirds of these passengers are currently

travelling further afield to use other London airports in order to access full service network airline routes. Stansted has taken the risk of upfront investment in new airport facilities (refurbishing Satellite 1) in anticipation of this future growth. Ryanair, Stansted's largest airline customer has secured a ten-year commercial contract with the airport and told us that this deal would likely not have been possible with BAA as owners. The Civil Aviation Authority (CAA) ended price control regulation for Stansted in January 2014 partly due to Stansted's successful price negotiations with airlines.

(b) **Edinburgh**: Since new ownership in 2012 Edinburgh has undergone significant change. The airport has adopted a new commercial and innovative focus which has already resulted in benefits to passengers through increased choice of routes; and operational and service improvements, as shown in Figure 1.3. Edinburgh's management team characterised the new strategy as significantly different from the approach under BAA ownership, which it described as having been unsupportive of improvements designed to increase competition between Edinburgh and other airports. Other stakeholders, including airlines noted operational and route development improvements at Edinburgh. Edinburgh's new strategy contrasts with BAA's historic approach to positioning Edinburgh as predominantly a business airport and since its divestment it has been actively competing for both business and leisure traffic. Edinburgh is starting to develop into a Scottish hub airport and generating benefits in the form of increased regional and international connectivity.

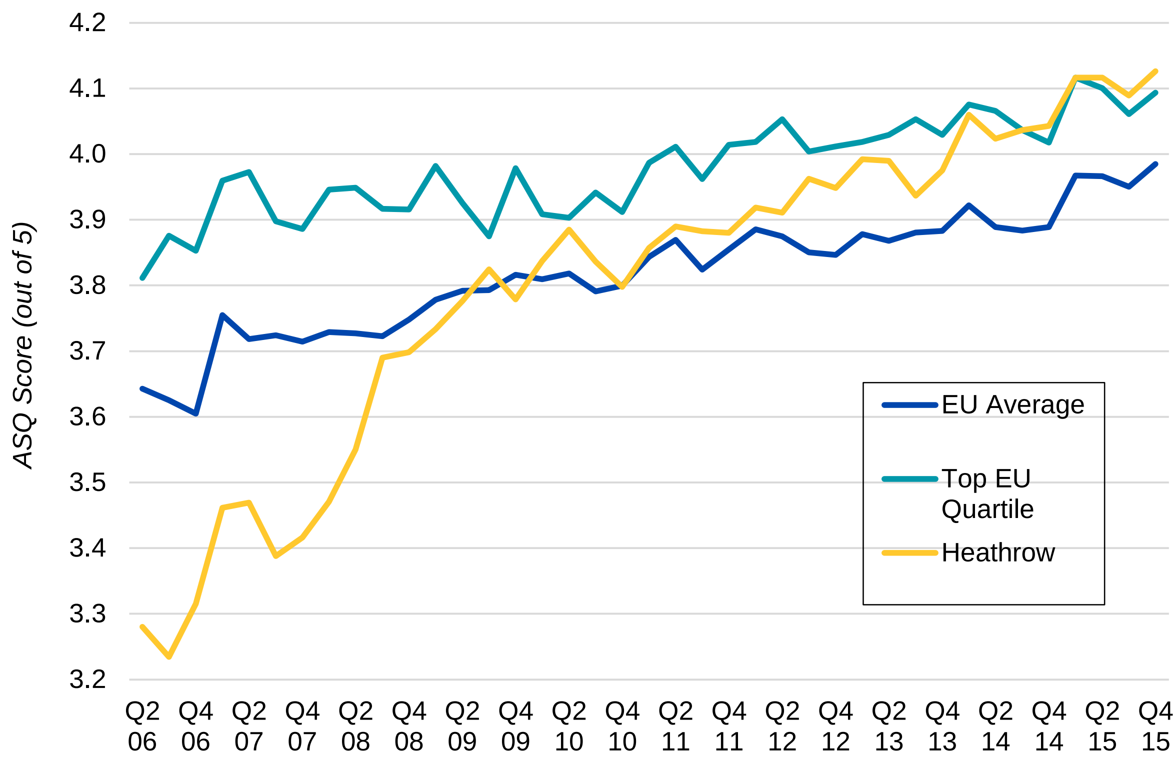
Figure 1.3: Efficiency and service improvements at Edinburgh check-in resulting from changes to operational processes



Source: CMA analysis of figures from Edinburgh.

(c) **Heathrow**: Heathrow's operations encompass both hub services, with 36% of total passengers transferring to onward flights in 2015, and point-to-point services. Heathrow's hub services compete with hub airports in Paris, Amsterdam, Frankfurt, Istanbul and the Middle East. Heathrow also competes with other London airports. For example, it has secured new routes relocating from Gatwick, as would be expected once the incentive to consider the profitability of other airports in the group had been removed by the break-up of BAA. Stakeholders told us that despite its continued market power and regulated status, Heathrow has responded to improvements at competitor divested airports. Heathrow's management recognises that operating as a stand-alone airport generates benefits given the scale and complexities of operations at Heathrow and marked service improvements have continued, as shown in Figure 1.4.

Figure 1.4: Heathrow passenger service quality scores 2006 – 2015 vs its European comparators



Source: Heathrow.

(d) **Glasgow**: Glasgow has increased its focus on providing a better customer experience in recent years with the introduction of a customer charter in 2012. Other strategic change at Glasgow since the CC investigation appears to have been incremental. The airport was sold by Heathrow Airport Holdings (previously BAA) to AGS Airports Limited in December 2014 and this may affect Glasgow's continuing strategy, including responses to changes at Edinburgh.

(e) **Aberdeen**: Aberdeen questioned the effectiveness of the reporting and consultation requirements imposed on it by the CC's remedies. These remedies were imposed with the aim of addressing what was deemed by the CC to be historically low levels of investment at Aberdeen and to inform future assessments of the airport's charges and profitability. Figures reported by Aberdeen do not indicate clear financial trends during the period covered by the remedies. However, stakeholders indicated that information provided would be expected to assist airlines negotiating with Aberdeen in the future.

Partial benefits quantified

1.8 It has been possible to quantify the magnitude of changes to passenger growth described in paragraph 1.6(a) above. Our independent consultant, ICF, has used econometric analysis based on statistical regression techniques to estimate the extent to which changes at the three divested airports differ from airports not directly subject to the CC's divestment remedies ('control group').

1.9 This analysis indicates that between 25 and 34 million more passenger journeys have taken place at the three divested airports (Gatwick, Edinburgh and Stansted) since the implementation of the CC's remedies. The change identified represents an average 9 to 12% increase at divested airports in the period following separate ownership over and above levels at comparable UK airports. This result is consistent with the view that BAA's common ownership of airports in the South-East had resulted in a segmentation of the market with a strong focus on Heathrow as the biggest, most profitable asset in the group. BAA operated Heathrow, Gatwick and Stansted in a 'London system' with these airports broadly positioned towards business/long-haul, leisure/short-haul and LCC passengers respectively. This result is also consistent with the view that BAA's historic approach in lowland Scotland positioned Edinburgh predominantly as serving business travel and Glasgow as lowland Scotland's leisure airport. The observed increase in passenger numbers suggests that, without this segmentation, airports under separate ownership have had greater incentive to compete for airlines and passengers and improve capacity utilisation.

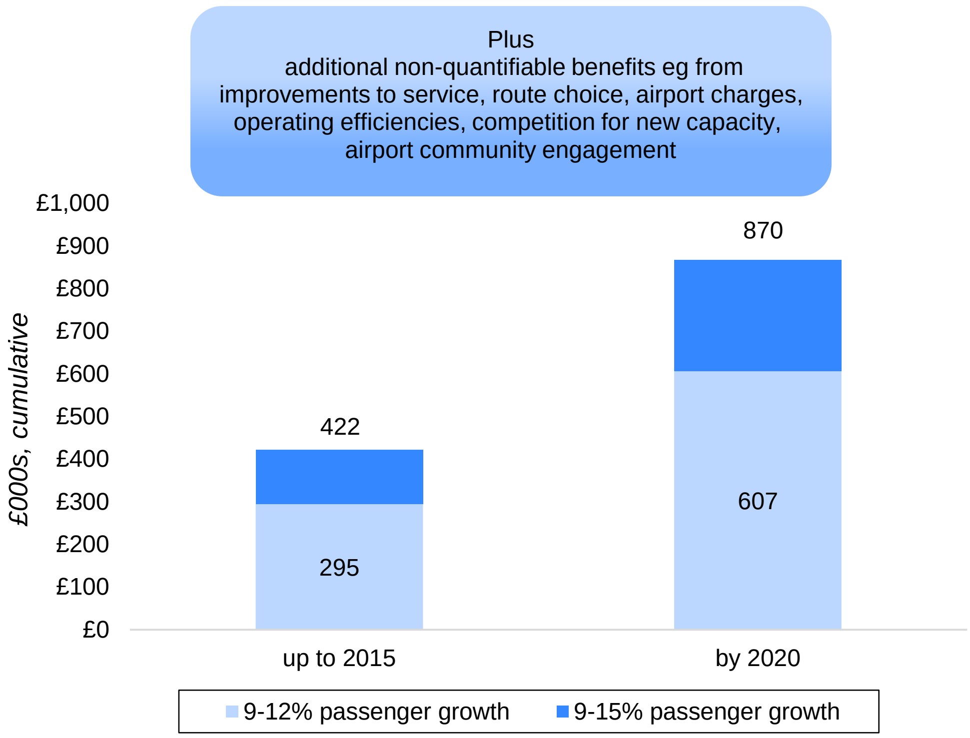
1.10 The higher level of passenger journeys identified by ICF's analysis represents growth over and above changes at non-divested airports during the period 2009 to 2015. ICF's analysis controls for long-term trends that would otherwise explain changes in passenger numbers at airports. It also controls for characteristics specific to individual airports, and was subject to sensitivity testing for timing and choice of comparator airports.

1.11 The statistically significant change measured for divested airports relative to non-divested airports, taken together with the qualitative evidence we have gathered indicates that divestment and resultant increase in competition was the most likely catalyst for increased levels of passenger journeys.

1.12 ICF combined available estimates produced by the International Transport Forum at the OECD in 2014 with its estimate of passenger growth to estimate the financial benefits to consumers. Based on this, the benefit to date of the 9 to 12% higher passenger numbers at divested airports estimated by ICF can be expressed in value terms at £295 million for the period 2009 to 2015. ICF's estimates also indicate that the annual level of passenger benefits was approximately £62 million in 2015, and further benefits are expected in the future. These estimates are based on assumptions about the value consumers derive from improvements in connectivity and choice leading to additional passenger journeys and reductions in travel costs for passengers. This estimate of partial benefits does not contain additional improvements observed, but not quantified in this evaluation, such as the service improvements or efficiency gains identified by qualitative evidence gathered and we therefore consider that calculations of the partial benefits to date are conservative.

1.13 ICF also undertook analysis in which Heathrow and Glasgow were omitted from the control group of comparator airports. While Heathrow and Glasgow were not directly subject to the CC's remedies, qualitative evidence indicates these airports have been affected by the actions of divested airports with which they compete. Results from this analysis, while subject to caveats, indicate that passenger numbers at divested airports increased by as much as 15% in the period following separate ownership. Assuming that the partial benefits measured by this approach continue to accrue at the rate quantified for 2015 estimated cumulative partial nominal benefits for the period 2009 to 2020 would total around £870 million at Gatwick, Stansted and Edinburgh (see Figure 1.5).

Figure 1.5: Estimated consumer benefits from increased passenger numbers at divested airports



Source: CMA summary of ICF's analysis (central estimates).

1.14 Estimates made by the Department for Transport (DfT) highlighted a total benefit of £195 million over a 20-year time horizon from reforms to the economic regulation of airports. Given the interaction between the CC's divestment remedies and the introduction of CAA12, there is likely to be some overlap between ICF's and the DfT's figures.

Additional non-quantifiable benefits

1.15 It has been difficult to quantify the value of changes to efficiency, service, routes, airport charges, competition for capacity development and airport community engagement described in paragraph 1.6 above. The relatively short period since divestment and mixed data quality for many sources of data has made it difficult to observe statistically significant changes and to quantify the magnitude of additional benefits. These changes are nonetheless important, particularly those most directly experienced by customers, for example, service improvements.

1.16 The weight and breadth of evidence in our evaluation, however, indicates that these important changes have already delivered passenger benefits in addition to the partial benefits measured by ICF's regression analysis. Four of the 28 stakeholders interviewed, including two full service network airlines, questioned the impact of the CC's remedies on the degree of competition in the market. The remaining stakeholders all considered that the CC's divestment remedies had delivered improvements to competition in the sector and highlighted specific changes that they regarded as unlikely to have been possible under BAA ownership. In addition several stakeholders told us that the CC's recommendations regarding the economic regulation framework had been an important catalyst for positive changes and increased levels of competition. However, many stakeholders mentioned that capacity constraints have limited the potential benefits of increased competition in the South-East.

1.17 There is therefore clear qualitative evidence of positive impact, sometimes appreciable, through all of the effects the CC envisaged. Good qualitative evidence from a broad range of stakeholders from across the aviation sector and independent industry observers indicates that changes in efficiency, service, airport charges, more efficient use of existing capacity, competition for new runway capacity and airport community engagement were unlikely to have happened without the CC's remedies, and certainly not to the same degree in the absence of CC intervention.

1.18 We note that some benefits only benefit consumers indirectly, such as developments in the nature of negotiations between airports and airlines, and changes in the relative bargaining position of these market players. The extensive contracts and commitments now in place between Gatwick and the large majority of its airline customers and important long-term deals agreed by Stansted suggests that the quality of commercial relationships between airlines and airports has improved since the CC's investigation. However, it is likely that the current capacity constraints in the South-East limit the extent to which airline competition can further develop in this area. This constraint consequently restricts the extent to which benefits are passed on to passengers.

1.19 Our assessment of the evidence to date indicates that the beneficial effects of competition are present not only on the divested airports. Other airports, including Heathrow, are likely to have responded to efforts made by divested airports to attract airlines and passengers through investment in facilities and services.

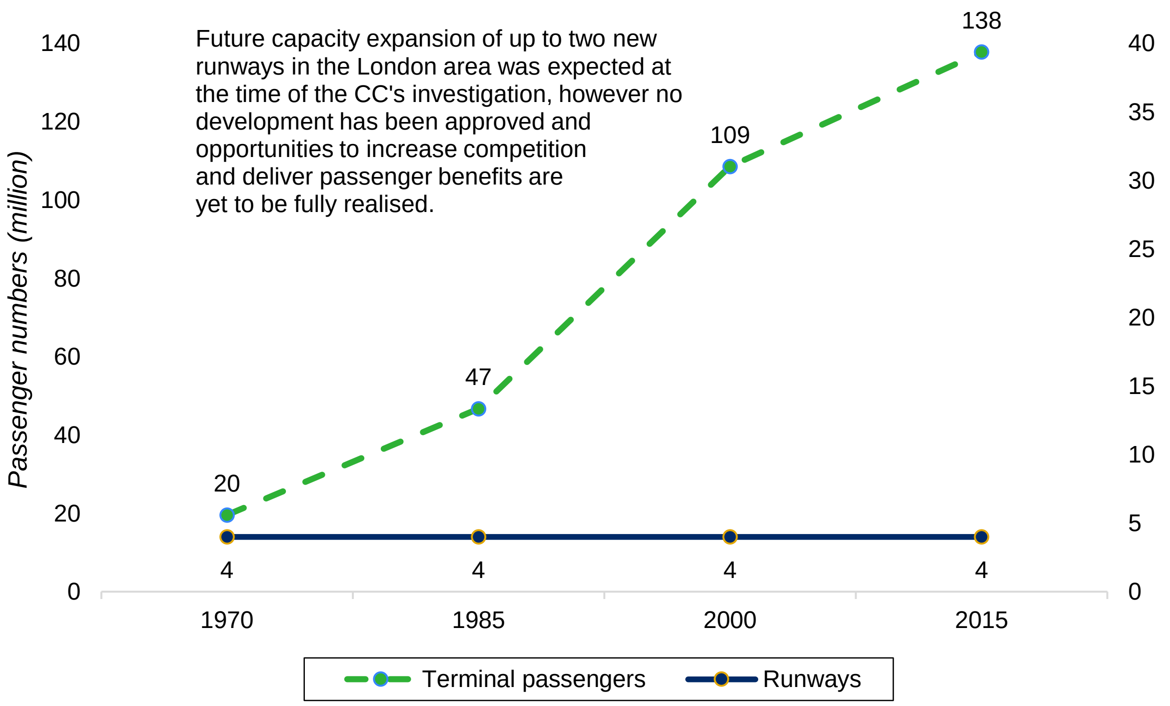
1.20 We therefore conclude that the level of benefit which has been quantified is conservative given that ICF's estimate is restricted to one measure – increased passenger numbers at the divested airports. It is reasonable to assume that further measurable benefits will become apparent in the future.

Limitations imposed by the absence of new runway capacity

1.21 We consider that the absence of new runway capacity in the South-East has limited the effective functioning of the CC's remedies and this means that the opportunities to increase competition and deliver passenger benefits have not yet been fully realised.

1.22 The CC envisaged that competition could be expected to develop between airports in the South-East within existing capacity constraints. However much of the benefit the CC foresaw from the removal of BAA's common ownership of Heathrow, Gatwick and Stansted was based on the expected future development of up to two additional runways in the South-East as was planned in 2009. However, as Figure 1.6 shows, while passenger demand has increased substantially at Heathrow, Gatwick and Stansted during the period 1970 to 2015, the number of runways at these airports has remained at four.

Figure 1.6: Annual terminal passenger numbers and runways at Heathrow, Gatwick and Stansted, 1970 to 2015



Source: CMA analysis of CAA data.
Note: Chart includes Heathrow, Gatwick and Stansted which were BAA's airports in London at the time of the 2009 investigation. We note that in the South-East there are other airports, for example London City, Luton and Southampton.

1.23 The CC said that the benefits would 'increase over time as the prospect of adding new capacity was realised and price control, at Gatwick and Stansted at least, is withdrawn as competition develops'. Benefits were seen as likely to accrue over the course of 30 years, facilitated by significant investment in new infrastructure.

1.24 The location of runway development is outside the scope of our evaluation. When considering remedy benefits, however, it is relevant to note that in the seven years since the CC's investigation, contrary to prevailing expectations at the time of the CC's final report, no new runways have been approved in the South-East. In this evaluation it has not been possible to quantify how much greater the impact of the CC's remedies would have been had runway expansion plans materialised. It seems likely, however, that the role the CC's remedies have already played in driving competition for the benefit of passengers since 2009 would have been greater if this key enabling factor had been present. During our evaluation, capacity constraints were frequently cited as reducing the potential benefits of increased competition by airports, airlines and the CAA.

1.25 On this basis it is reasonable to draw the conclusion that if capacity constraints in the South-East were relieved the effect of the CC's remedies would be significantly enhanced. In the presence of capacity constraints, airports are limited in their ability to increase volumes by reducing airport charges and hence have little incentive to offer discounts to airlines. In contrast, with spare capacity, airports would be even more proactive in approaching airlines and offering discounts to attract them to fill capacity. From the airlines' perspective, the main disciplining force they can use to incentivise airports to reduce charges and increase service quality is the threat of switching some of their routes, or their entire operations, to alternative airports. However, this is only a plausible and credible strategy if there is spare capacity at those other airports. Therefore, we consider that additional capacity in the South-East would strengthen the process of rivalry between airports to win and retain airlines and would also increase competition between airlines. This would benefit airports users through:

(a) lower air fares as additional capacity would make it easier for airlines to expand their operations at airports; this would put downward pressure on airlines' fares through increased competition;

(b) further improvements in service quality as a result of airports competing more intensely for airlines and passengers;

(c) potentially lower airport charges, although this would also be affected by the cost of expansion, the expanding airport's approach to recovering investment costs and competitive responses by other airports; and

(d) greater choice in the form of further route development. Airlines told us that capacity constraints limited their ability to switch operations between airports. Capacity constraints also prevent new airlines commencing services from airports. For example, Heathrow told us that around 80 airlines operated there now and over 30 additional airlines would like to operate from Heathrow but were unable to do so due to capacity constraints. Gatwick has around 50 current airlines and around 16 airlines wishing to use Gatwick but unable to do so due to capacity limitations.

Potential unintended consequences

1.26 Three potential unintended consequences were identified by stakeholders during our evaluation. The evidence we have collected suggests that these have not significantly undermined the benefits of the CC remedies.

(a) Heathrow suggested the divestment of the airports required by the CC's remedies may have led to the earlier divestment of BAA's remaining regional airports in Southampton, Glasgow and Aberdeen than would otherwise have been the case, with consequent loss of synergies from common ownership. However, Heathrow also noted that its board had recognised that operating Heathrow as a stand-alone airport gave rise to benefits given the scale and complexities of this airport. We note that other airports and other stakeholders have not indicated that economies of scale arising from common ownership of multiple airports are appreciable.

(b) It was suggested that airports competing to secure permission for new runway capacity in the South-East may have incurred additional lobbying and advertising costs and extended the duration of government review. It is not possible to compare how costs and time might have been different under common ownership. We note that any higher spend that has been incurred is likely to have been accompanied by an increase in the quality of the expansion proposals.

(c) Views were mixed regarding the position of Prestwick airport. A number of stakeholders thought that Prestwick's decline could be attributed to the CC's remedies. Others considered that factors such as Prestwick's location and strategic decisions by airlines were more likely to have caused changes at this airport.

Costs and proportionality

1.27 As part of our evaluation we examined the costs incurred by BAA in selling the airports required by the CC's remedies. Divestment costs mostly related to

IT spend required to allow airport assets to operate as a stand-alone business and fees paid by BAA to advisers. We compared BAA's actual costs of £95 million with estimates made by BAA and by the CC. This showed that the CC's estimates were close to those which were actually incurred and the CC's decision to use its own lower estimate as opposed to BAA's projections was well judged.

1.28 We also considered the scale of divestment costs relative to the value of consumer benefits quantified by ICF to date. This comparison indicated that the partial benefits quantified to date, solely from growth in passenger numbers at divested airports, have significantly outweighed divestment costs. Taking into account the timing of costs and benefits quantified, the partial cumulative benefits identified to date had exceeded costs well before the end of 2012. For the reasons discussed above it is clear that substantial benefits will continue to accrue. On this basis, taking a conservative approach (see Figure 1.5) and using only the limited benefits it has been possible to quantify, we estimate that by 2020 the value of consumer benefits would be a factor of six times higher than divestment costs.

1.29 In light of this analysis, which accords with views of the majority of stakeholders, it can be shown that the benefits associated with the CC's divestment remedies have already clearly outweighed the costs of putting them in place.

The CC's remedies process and lessons learnt

1.30 In addition to assessing the impact of the remedies, our evaluation gathered views on the remedies process and considered whether lessons can be learnt from the CC's design and implementation of remedies.

1.31 While the CC looked at the regulatory environment, a broader range of enabling factors could have been considered by the CC. Some stakeholders have identified that the remedies might have worked more effectively if the activities of other agencies providing services outside the control of airports, such as border control and transport connections, had also been included in the scope of the CC's remedies. Otherwise stakeholders told us that the remedies process worked well.

1.32 Our evaluation identified lessons learnt in the following areas: (i) the importance of establishing and maintaining professional, constructive working relationships between the competition agency and the party implementing a divestment remedy; (ii) a monitoring trustee (MT) can add significant value to the divestiture process; (iii) there are benefits to be gained, from taking a flexible approach to implementing remedies, particularly in complex divestments where this can be achieved without compromising effectiveness; and (iv) the remedies process benefits from prompt resolution of uncertainties, for example, regarding the roles of the competition agency, vendor and other professional advisers involved.

1.33 All stakeholders providing views were complimentary about the transparency of the remedies process. All parties involved in the divestments, including unsuccessful bidders welcomed the clear guidelines, timetable and consultative nature of the CC’s approach. Stakeholders said they understood the CC process and had appropriate opportunities to influence this.

1.34 Stakeholders generally considered that the divestment timetable set by the CC was workable and that disposals were completed relatively swiftly given BAA’s legal challenges, the large, complex assets involved and the need to judge consortium bids. The adaptability of the CC to the sequencing of the divestment remedies, whereby the order of divestments of Stansted and either Glasgow or Edinburgh was changed, was also seen as positive.

1.35 The CC worked alongside an MT, Grant Thornton, to assess the credibility of bidders in terms of financial resources, management expertise and independence. This was recognised as having been important to ensure the successful bidder would be in a position to operate the acquired airport successfully. The CC and the MT also made strenuous efforts to ensure the CC’s involvement in no way stifled BAA’s sale process and that a competitive auction process for each of the three assets was achieved. All stakeholders interviewed thought that the three main parties in the process – BAA, Grant Thornton and the CC – worked well together in a professional manner to implement the divestments and achieved a successful, smooth and appropriately paced divestment process.

2. Introduction

2.1 Each year the Competition and Markets Authority (CMA) undertakes two ex post evaluations of past actions of the UK competition authorities. This is in line with its performance framework agreement with the Department for Business, Innovation & Skills (BIS)[1] which also sets out that at least one of these evaluations should concern a market study or investigation. Ex post evaluations are also part of the CMA's programme of remedy reviews initiated by the CC.

2.2 For the year 2015/16, the markets project that the CMA has chosen to evaluate is the CC's BAA airports market investigation.

2.3 Following a reference by the Office of Fair Trading (OFT) in 2007, the CC launched a market investigation into the supply of airport services by BAA. In 2009 the CC published its final report in which it concluded that BAA's common ownership of airports in south-east England and lowland Scotland gave rise to adverse effects on competition (AECs). It also concluded that a number of other features of the relevant markets, including (i) Heathrow Airport's (Heathrow's) position as a hub airport; (ii) Aberdeen Airport's (Aberdeen's) comparatively isolated geographical position; (iii) aspects of the planning system and government policy; and (iv) the regulatory system for airports, gave rise to AECs.

2.4 Having identified these AECs, the CC put in place a substantial package of remedies, namely:

(a) the divestment of Stansted Airport (Stansted) and Gatwick Airport (Gatwick) to different purchasers;

(b) the divestment of either Edinburgh Airport (Edinburgh) or Glasgow Airport (Glasgow);

(c) the strengthening of consultation procedures and provisions on quality of service at Heathrow, until a new regulatory system was introduced;

(d) undertakings in relation to Aberdeen, to require the reporting of relevant information and consultation with stakeholders on capex; and

---

[1] For further details on the CMA performance framework agreement with BIS, see *Competition and Markets Authority: Performance Management Framework*, January 2014.

(e) recommendations to the DfT in relation to economic regulation of airports and government policy.[2]

2.5 We undertake evaluations for a number of reasons, including to evaluate the impact of our decisions and to learn lessons. As set out in the terms of reference,[3] in this particular evaluation we have focused on the following areas:

(a) The impact of the divestiture remedies, both in south-east England and lowland Scotland.

(b) The impact of the behavioural remedies on Aberdeen.

(c) The impact of changes in the regulatory framework.

(d) The proportionality of the CC's remedies in light of their impact.

(e) The lessons we can learn from the CC's remedies process and the implementation of the remedies.

2.6 For the impact assessment (points *(a)* to *(c)* above) we aimed at quantifying the benefits to consumers that have arisen to date from the CC's remedies to the extent it was possible. In order to support our work, we commissioned a report from ICF that focuses on the assessment and quantification of these benefits. ICF's report is published alongside our report and we make reference to ICF's results in our analysis where appropriate.

2.7 We used a combination of quantitative and qualitative evidence from a range of evidence sources and stakeholders to complete our analysis. At the outset of the evaluation project, we published our terms of reference[4] and invited comments and evidence from stakeholders. A number of stakeholders made submissions to us in response to the terms of reference that we took into account in our analysis. In addition, we directly contacted and interviewed various stakeholders, in some cases as part of a site visit. Stakeholders interviewed for this evaluation project included a number of UK airports, various airlines (full service network carriers, LCCs, regional and cargo operators) and regulators. The list of stakeholders we engaged with is in Appendix 1 of this document. Although the CMA does not have any formal information gathering powers when conducting evaluations, we experienced

---

[2] The CC did not consider that remedies were required to address those features of planning restrictions that restricted competition given the introduction of significant improvements to the planning process through reforms, including the Planning Act 2008. CC (2009), *BAA airports market investigation – A report on the supply of airport services by BAA in the UK* (2009 report), p15.
[3] See the terms of reference.
[4] Ibid.

cooperation from a wide range of stakeholders. We should like to thank all those who have assisted us in our evaluation.

2.8 We used the CC's expectations about the likely impact of the remedies as set out in its report as a starting point for our analysis. However, we kept an open mind to identifying any unintended (positive or negative) consequences of the remedies throughout the evidence gathering process. During our evidence gathering we received some feedback on issues that are not directly related to the CC's remedies, for example, in relation to regulatory decisions and the work of other government departments. We make reference to these points where appropriate only to the extent they might have affected the potential impact of the CC's remedies. We also note that the ongoing runway debate and the Airports Commission's recommendation on where the UK's new runway should be built was not in the scope of our evaluation. We have, however, taken into account views on how the divestment remedies affected the process by which airports have competed for new runway capacity in south-east England and the benefits, costs and wider consequences which have arisen from this.

2.9 As recognised in our terms of reference, we have faced some challenges in carrying out this evaluation. An important conceptual issue for any ex post evaluation of competition authorities' past interventions is to establish a suitable counterfactual against which we assess the impact of the intervention. In other words, we want to look at the evolution of the market since the intervention and identify which of the changes happened as a result of the actions of the competition authority (in this case the CC) and separate these from the changes that would have happened irrespective of the intervention. In this evaluation, this has proved to be a complex task due to the large number of factors that have affected the market since the CC's remedies, including the recovery from the 2008 financial crisis, technological changes and changes in airline business models. It has not been possible to identify how BAA would have reacted to these changes absent the CC's remedies. Therefore, we used ICF's quantitative analysis, as set out in section 3 of its report, and qualitative information from stakeholders to identify what changes were likely to be a result of the CC's remedies rather than other external factors and what changes would have been unlikely to happen under BAA ownership. All stakeholder interviews were conducted with this in mind, looking for examples and case studies demonstrating changes that would have been unlikely or less likely under common ownership.

2.10 Changes in corporate structures and staff movements (including between airports) since the investigation also posed practical challenges, especially in relation to the evaluation of the CC's remedies process. We actively sought to identify the right individuals within the company to speak to wherever it was possible, and structured interviews to be clear about the capacity in which their views were gathered. As mentioned above, we also sought to interview a wide range of stakeholders and gathered data from a variety of sources to validate views.

2.11 We consider our impact estimates to be conservative for the reasons listed below:

- **Time needed for benefits to materialise**: In its final report, the CC highlighted that the main benefits from the divestitures in south-east England would result from dynamic aspects of competition, improving the way in which the airports deliver capacity, and that these benefits may not manifest themselves for several years.[5] More generally, a number of stakeholders told us that the divestitures were not sufficiently long ago to be able to assess all possible benefits, even if some of the benefits have already materialised. This is particularly the case in relation to Stansted which was divested only three years ago in 2013. Therefore, we expect further benefits to result from the remedies in the future that are not captured in our impact assessment.

- **Difficulty in quantifying benefits**: Some of the benefits that may have resulted from the remedies are inherently difficult to quantify. For example, assessing the impact on airfares paid by passengers would have been extremely difficult due to the highly complex nature of airfare setting and the data requirements of such an exercise (including data on fares and relevant costs). In those cases where the quantification of benefits was not feasible, we relied on qualitative information to illustrate the impact of the remedies.

2.12 One of the main objectives of this evaluation is to quantify consumer benefits. However, some of the benefits, such as changes in the nature of the negotiations between airports and airlines and changes in the relative bargaining position of these market players, may only indirectly affect consumers depending on airlines' actions. The focus of this evaluation was the impact of the CC's remedies on the provision of airport services and hence we did not analyse airline competition and airlines' behaviour in detail. However, wherever possible, we used evidence to assess how any changes

[5] CC (2009), *BAA airports market investigation – A report on the supply of airport services by BAA in the UK* (2009 report), p15.

in the interactions between airports and airlines have indirectly benefited or are likely to benefit consumers.[6]

2.13 The remainder of this report is organised as follows:

- Section 3 provides background on the CC's market investigation and the expected impact of the CC's remedies.
- Section 4 gives a brief overview of the most important changes that have affected the market for the supply of airport services in south-east England and lowland Scotland since the CC's market investigation.
- Section 5 focuses on the impact of the CC's remedies in each affected geographic area and more broadly. For each geographic area, it sets out the qualitative evidence from stakeholder interviews and desk based research and refers to ICF's quantitative analysis where applicable. This section also presents case studies to illustrate the impact of the remedies.
- Section 6 sets out our findings about the costs of remedy implementation, and our assessment of the proportionality of the remedies in light of benefits and costs.
- Section 7 summarises views from stakeholders on the CC's remedies process.

---

[6] We note that the current capacity constraints in the South-East limit the extent to which airline competition can further develop in the South-East. This constraint consequently restricts the extent to which benefits are passed on to passengers.

3. The Competition Commission's 2009 investigation

Competition problems identified by the CC's 2009 market investigation

3.1 In March 2009 the CC concluded its investigation into the airports market and found there was 'no competition' between the seven airports owned by BAA.[7] At that time BAA's airports controlled 81% of London's runway capacity and serviced 62% of UK passengers.[8,9] BAA's Scottish airports (Glasgow, Edinburgh and Aberdeen) accounted for 85% of passengers using Scottish airports in 2007. In lowland Scotland, BAA's airports (Glasgow and Edinburgh) accounted for 88% of passengers in 2007.

3.2 Having looked at the structure of the airports market and BAA's performance, the CC concluded there was significant scope for competition between BAA's airports, and that rivalry would bring substantial benefits to consumers and other airport users.

3.3 In particular, the CC envisaged that in the absence of common ownership of the three airports in the South-East:

- there would be competition between Gatwick and Stansted;
- there would be competition between Heathrow and Gatwick, albeit the impact on Heathrow may be reduced by its unilateral market power as a result of its hub status; and
- there would be competition between Heathrow and Stansted, albeit the impact on Heathrow may be reduced by its unilateral market power as a result of its hub status.[10]

3.4 Regarding lowland Scotland, the CC considered that Edinburgh's closest substitute was Glasgow and Glasgow's closest substitute was Edinburgh. Given the substitutability between these airports, the CC expected competition to develop between them in the absence of common ownership.[11]

---

[7] 2009 report, paragraph 3.26. BAA's airports at the time of the investigation were Heathrow, Gatwick, Stansted and Southampton in the South of England, and Edinburgh, Glasgow and Aberdeen in Scotland.
[8] Runway capacity in London. CC calculations based on 2010 air traffic movements (ATMs) see 2009 report, Table 5.1. Share of passenger data, see 2009 report, Table 1.1, relates to both 2007 and 2008. 2009 report, Table 3.1 and paragraph 3.35.
[9] CC analysis indicated that in 2008 BAA accounted for about 90% of airport passengers in south-east England see 2009 report, paragraph 1.9.
[10] 2009 report, paragraph 5.13.
[11] 2009 report, paragraph 5.4.

3.5 The CC envisaged that competition would bring benefits to passengers and airlines in the form of improved service standards, greater innovation, more efficient investment in infrastructure (including investment in future runway capacity), wider choice, stronger operational performance, lower prices, reduced financing risk, and would enable progressive deregulation.[12]

3.6 While some of these benefits were envisaged to be felt shortly after the implementation of the remedies, the CC also recognised that impact was likely to become more significant in the longer run as additional runway capacity in the South-East became available. The CC's expectations and the timing of the likely benefits is discussed in more detail in paragraphs 3.24 to 3.32.

3.7 Benefits to passengers and other airport users were set against the backdrop of BAA's performance prior to the CC's market investigation. The CC's market investigation concluded that many of BAA's airports were underperforming in several areas, with many aspects of BAA's performance also affected by shortcomings in the regulatory system for the London airports (Heathrow, Gatwick and Stansted). The main areas of underperformance identified by the CC were related to investment and service standards as set out below.

Investment

3.8 With regard to investment by BAA, the CC found a lack of responsiveness to the interests of airlines and other users on capex at the BAA airports, and said that it would not expect this in a well-functioning market.[13] Investment levels were of particular concern given the regulatory mechanism in place for all three airports in the South-East at the time which allowed for spending by BAA to result in higher prices charged to airlines for airport services.

Service

3.9 Service rankings for BAA's London airports were historically poor compared with similar airports, although some improvements were evident by the time the 2009 report was published. Table 3.1 (Table 7.3 from the 2009 report),[14] shows significant quality of service deficiencies in 2007 in the London airports, as indicated by the ratings of the overall airport experience compared with overseas airports: Heathrow was ranked 90th, Gatwick 75th and Stansted

---

[12] 2009 report, paragraphs 5.30, 5.34, 5.42, 7.135, 10.64, 10.360 and Appendix 5.1 paragraph 6.
[13] 2009 report, paragraph 7.74.
[14] Data summarises results of the Airport Service Quality (ASQ) rankings from surveys carried out for Airports Council International (ACI) of passenger perception of service quality at different airports in 2007 and 2008. Of the many indicators on which data is available, the table presents ratings of the overall experience of BAA airports, compared with the 101 airports surveyed in 2007, and 127 surveyed in 2008.

74th of 101 airports. Rankings were particularly poor for security queue waiting times: Stansted 98th, Heathrow 97th and Gatwick 93rd of 101 airports compared. The table also shows that at all three BAA London airports about one-third of passengers reported that they queued for more than 10 minutes at security in 2007.

Table 3.1: Quality of service indicators

	ACI ASQ rankings of overall satisfaction with the airport		*ACI ASQ rankings of security queue waiting times*		*BAA QSM % passengers perceiving over 10 minutes security queuing*	
	2007	*2008*	*2007*	*2008*	*2007*	*2008*
Heathrow	90/101	98/127	97/101	91/127	33	12
T1					28	7
T2					28	11
T3					43	15
T4					28	15
T5						11
Gatwick	75/101	83/127	93/101	61/127	34	7
South					37	9
North					28	5
Stansted	74/101	82/127	98/101	99/127	31	18
Southampton	35/101	33/127	12/101	11/127	1	1
Glasgow	54/101	62/127	26/101	25/127	6	5
Edinburgh	46/101	56/127	44/101	69/127	5	3
Aberdeen	60/101	80/127	49/101	52/127	6	3

Source: ACI, BAA.
Note: The Quality Service Monitor (QSM) score was based on a survey conducted by BAA.

Other factors

3.10 Other aspects of BAA's performance the CC considered were route development (including in Scotland), financial performance, pricing, efficiency and financing.15 Appendix 2 of this report contains further detail on this.

Aberdeen's performance

3.11 The CC noted Aberdeen's comparatively isolated position relative to other centres of population. It is situated around 2h by car from Dundee airport and 2h30m from Edinburgh, the nearest airports to the south, and 2h15m from Inverness, which is the nearest airport to the north. Aberdeen serves the offshore oil industry and part of its business is providing a base for helicopter flights to the North Sea.[16] The problems identified by the CC at Aberdeen derived from its comparatively isolated geographical position and included

[15] See 2009 report, paragraph 7.2.
[16] In 2007/08, helicopter flights accounted for 15% of Aberdeen's airport charges.

underinvestment, poor facilities and relatively high levels of prices and profitability.[17,18]

Interventions to address competition problems identified

3.12 To address the competition problems found, the CC concluded that several interventions were required (the CC's remedies), the most substantial of which was an order for BAA to sell three airports (Gatwick, Stansted and either Glasgow or Edinburgh). The CC also recommended changes to government policy and regulation, and imposed a requirement on Aberdeen Airport to improve consultation with airlines and to publish certain financial and other information. Key information on these four remedy areas follows and further detail is included in Appendix 2. The CC's remedy to strengthen consultation procedures and provisions on quality of service at Heathrow is not considered further. This is because this remedy was developed as a temporary measure until a new regulatory system was introduced and was superseded by new legislation (see below under regulation).

Divestments

3.13 The CC found that the common ownership of BAA's airports in the South-East and of Glasgow and Edinburgh in lowland Scotland precluded any competition between them. The CC expected that the sale of both Gatwick and Stansted as well as either Edinburgh or Glasgow[19] to new owners would bring substantial benefits to passengers and airlines both directly and indirectly. Direct benefits were expected from the greater incentive that new owners would have compared with BAA to respond to customers' needs. The CC expected further benefits to arise in an indirect way as BAA responded to actions taken by these new competitors.

Government policy

3.14 At the time of the CC's investigation, government policy on runway expansion had been determined by the Air Transport White Paper (the White Paper),

[17] CC analysis estimated that prices at Aberdeen, measured using net airport charges paid per passenger by passenger airlines, were about 30% above the average for non-BAA airports in 2005 and 2006. 2009 report, Appendix 10.7, paragraph 7.
[18] We note that high profitability is not a problem in itself but, in combination with other factors, can be an indicator of high prices and underlying market power.
[19] With regard to Scotland, the CC's decision did not specify which airport would need to be divested by BAA and the option of either Glasgow or Edinburgh was left to BAA to decide. This was because there was not a sufficiently strong case in terms of competition factors to specify which of BAA's airports in lowland Scotland should be sold. See CC press release, p2.

which had been published six years earlier. The CC had two concerns regarding the White Paper.[20]

- First, the White Paper's preference for runway expansion at Stansted or Heathrow increased the risk of further delay in delivering additional capacity and reduced the prospect of expansion elsewhere.

- Second, the White Paper was too specific about the runway services that airports should provide and the type of runway that should be built.[21]

3.15 To address concerns around government policy, the CC made a recommendation to the DfT. The recommendation sought to ensure that government policy did not constrain the airports market and that it would be possible for the new owners of Gatwick to compete with other airports in the South-East for permission to build a second runway in the future.

Regulation

3.16 The CC concluded that regulation at the time of the investigation had created problems with (i) investment by airports and (ii) the quality of service provided to passengers and airlines. In light of these concerns the CC sought to modernise the regulatory framework by making recommendations to the DfT.

3.17 The CC's main recommendation sought to change the remit of the aviation regulator, the CAA, to increase its focus on promoting consumers' interests through competition, whilst specifically taking into account the views of airlines. In order to achieve this the CC recommended the introduction of licences for airports that could be flexed in view of the individual circumstances of each airport. This contrasted with the uniform approach to regulation that was in place at the time with the type of regulation dependant on whether or not the airport was 'designated'.[22]

3.18 At the time of the investigation the DfT was conducting a review of airport regulation and noted that the CC's investigation had provided further and very important evidence to its work. Many of the CC's proposals were consistent

---

[20] DFT White Paper (2003), *The Future of Air Transport*.
[21] 2009 report, p112, paragraph 4.76(c) ie parallel runways (including mix mode) or segregated parallel operations.
[22] The decision to designate an airport under the Airports Act 1986 was taken by the Secretary of State based on three criteria (i) whether the airport has or is likely to acquire substantial market power, (ii) whether competition law is sufficient to address the risk that, absent regulation, the airport would increase and sustain prices profitably above the competitive level or restrict output or quality below the competitive level, and (iii) relative costs and benefits.

with, or similar to, the proposals the DfT was considering,[23] and following consultation by the DfT new regulation was introduced in the form of CAA12.[24]

3.19 CAA12 introduced a number of important changes to the powers and responsibilities of the CAA including:

(a) giving the CAA a single overriding duty, for its airport economic functions, to further the interests of passengers and owners of cargo in the provision of airport operation services;

(b) creating a flexible licensing regime for regulated airports, enabling the CAA to include licence conditions that require airports to respond more effectively when things go wrong (for example severe weather conditions); and

(c) allowing the CAA, where appropriate, to replace fixed-price caps on airports with lighter touch forms of regulation with decisions on whether an airport should be price regulated and how based on a 'three part' market power determination (MPD) test.[25]

3.20 Regulatory changes including the revised appeal process against MPDs are considered further later in this report and in Appendix 2.

Behavioural remedy at Aberdeen

3.21 The CC decided to require undertakings from Aberdeen covering two aspects as follows:

(a) A requirement to publish audited accounts and segmental analysis on a depreciated replacement cost basis for Aberdeen (for the last five years and independently audited) together with: segmental analysis of the value of tangible assets on a depreciated replacement cost basis split by major categories of aeronautical and non-aeronautical assets; segmental analysis of revenue, operating costs and profits for major categories of aeronautical and non-aeronautical services; depreciated replacement cost return on capital employed; and average annual yield for fixed-wing aircraft and rotary aircraft and average yield per airline.[26]

[23] DfT consultation, March 2009, p10.
[24] DFT announcement, 19 December 2012.
[25] CAA12 section 6. Test A: the relevant operator has or is likely to acquire substantial market power (SMP), test B: competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that SMP, and test C: for users of air transport services, the benefits of regulating the relevant airport operator by means of a licence are likely to outweigh the adverse effects.
[26] 2009 report, paragraph 10.215(a).

(b) A requirement to consult at least annually with airport users and other relevant stakeholders at Aberdeen regarding its prospective capex programme, involving the timely publication of information on the airport master plan, a summary forward programme of capital projects together with forecast costs and details of individual key projects to the airlines and other interested parties and the creation of a forum for the proposals to be discussed.[27]

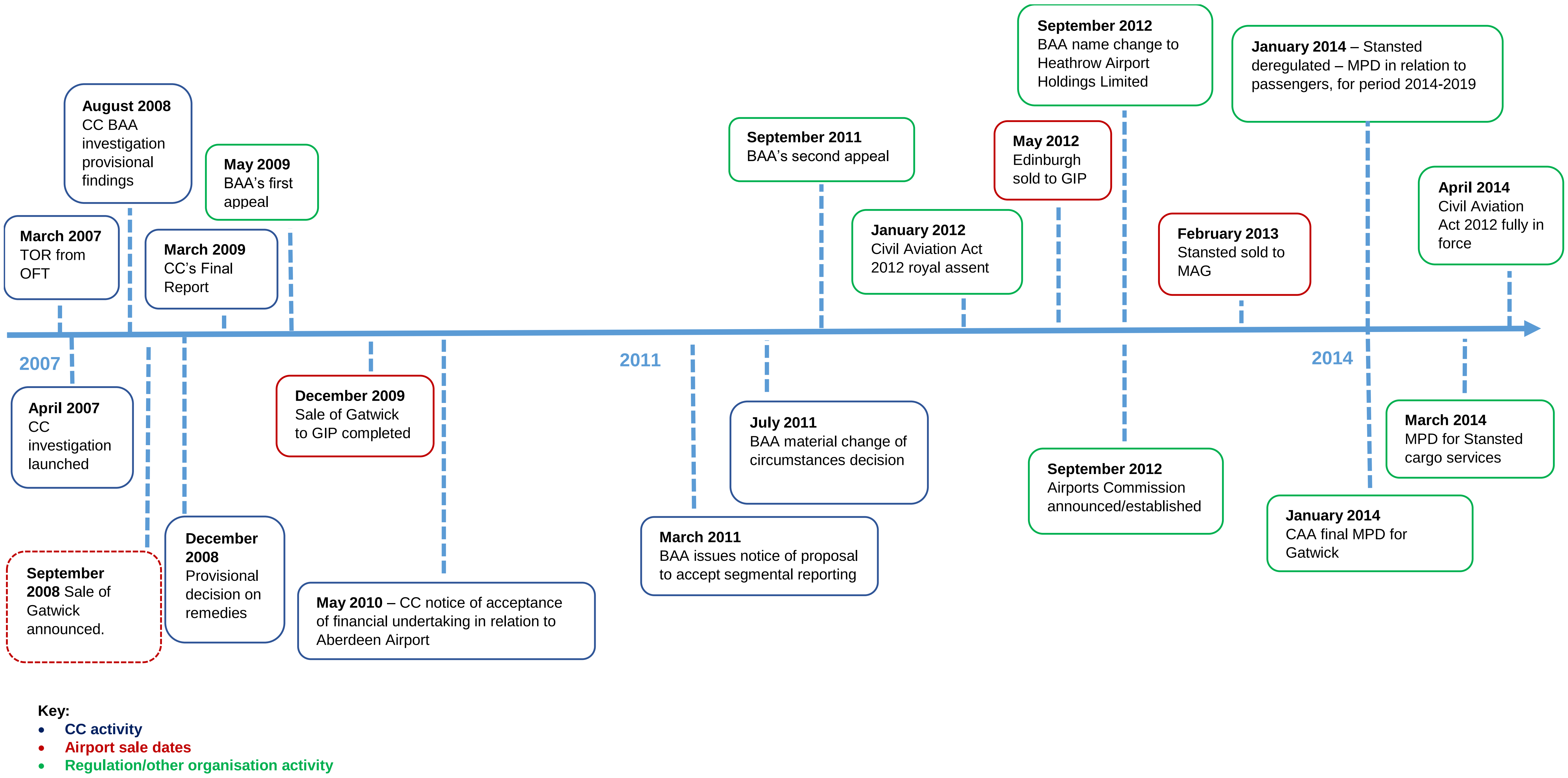
Timing of the CC's remedies

3.22 Implementation of several of the CC's remedies started in 2009, including (i) the sale of Gatwick, (ii) changes to government policy and regulation and (iii) new obligations on Aberdeen's operations. BAA, however, appealed the CC's order to sell Stansted and one of its Scottish airports in May 2009, and made a further appeal over the sale of Stansted in September 2011. Edinburgh was divested in May 2012. The divestment process for Stansted was completed in February 2013 after BAA's legal challenges were unsuccessful.[28] CAA12 came fully into force in April 2014.

3.23 Figure 3.1 shows the timing of the main events relating to the CC's investigation, the development/implementation of remedies and regulatory changes. Following the sale of Gatwick and Edinburgh, and in anticipation of the sale of Stansted, BAA changed its name and became Heathrow Airport Holdings Limited on 21 September 2012.[29]

[27] 2009 report, paragraph 10.215(b).
[28] During the period from May 2009 to February 2012 BAA made two unsuccessful appeals relating to the CC's 2009 investigation. Details of these appeals are described in Appendix 2.
[29] Heathrow Airport Holdings Limited Accounts to 31 December 2012, p4.

Figure 3.1: Timeline of main events, 2007 to 2014



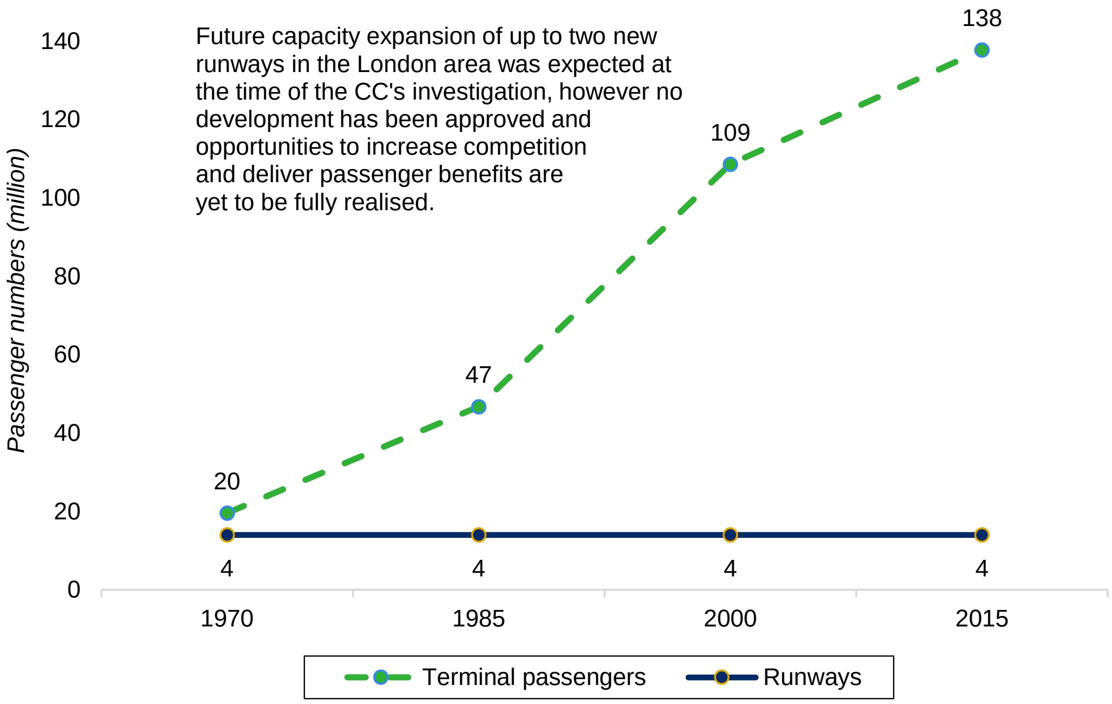
Benefits expected and the role of runway capacity

3.24 As described above in paragraph 3.2, the CC expected the remedies to drive improvements in the competitive process in several different areas. The CC did not, however, expect the remedies to fundamentally change Heathrow's market power and recognised that Heathrow was likely to require continued price control for the foreseeable future. One of the reasons the CC expected Heathrow to retain substantial market power was due to its hub status facilitated by its extensive terminal facilities and two full length runways.[30,31]

3.25 Runway capacity is also relevant when considering the timing of benefits expected, especially in the South-East. Figure 3.2 shows the number of passengers and runways over the period 1975 to 2015 at what were BAA's London airports. It shows that despite significant growth in passenger numbers, the development of the two new runways expected at the time of the investigation has not taken place.[32] The number of runways at BAA's former London airports has remained at four[33] and all these airports face capacity constraints at peak times.[34]

[30] In a hub-and-spoke model, airlines and alliances focus their route networks on one or more key airports that maximise connecting opportunities for passengers. Additional passengers transiting through hub airports make it more viable for the airport to add new routes at that airport or increase frequencies on existing routes. Not all airports are equally suited to hosting an aviation hub. Typically an airline or alliance will want to concentrate its flights into 'waves' of arrivals and departures, with a short interval to transfer arriving passengers and luggage onto connecting flights. To facilitate this the airport must have sufficient runway, apron and terminal capacity to enable this kind of scheduling.
[31] 2009 report, paragraphs 5.7 & 5.8.
[32] The CC noted that BAA intended to increase Heathrow's capacity, including a third runway, with implementation around 2015 to 2020, see 2009 report, paragraph 3.127g. A second runway was envisaged at Stansted, see 2009 report, paragraph 5.16e.
[33] We note that London is part of the South-East which includes additional airports and runways for example London City, Luton, Southend, Biggin Hill and Lydd.
[34] See ICF's report, p7, for data on overall capacity utilisation of these airports.

Figure 3.2: Annual terminal passenger numbers and runways at Heathrow, Gatwick and Stansted, 1970 to 2015



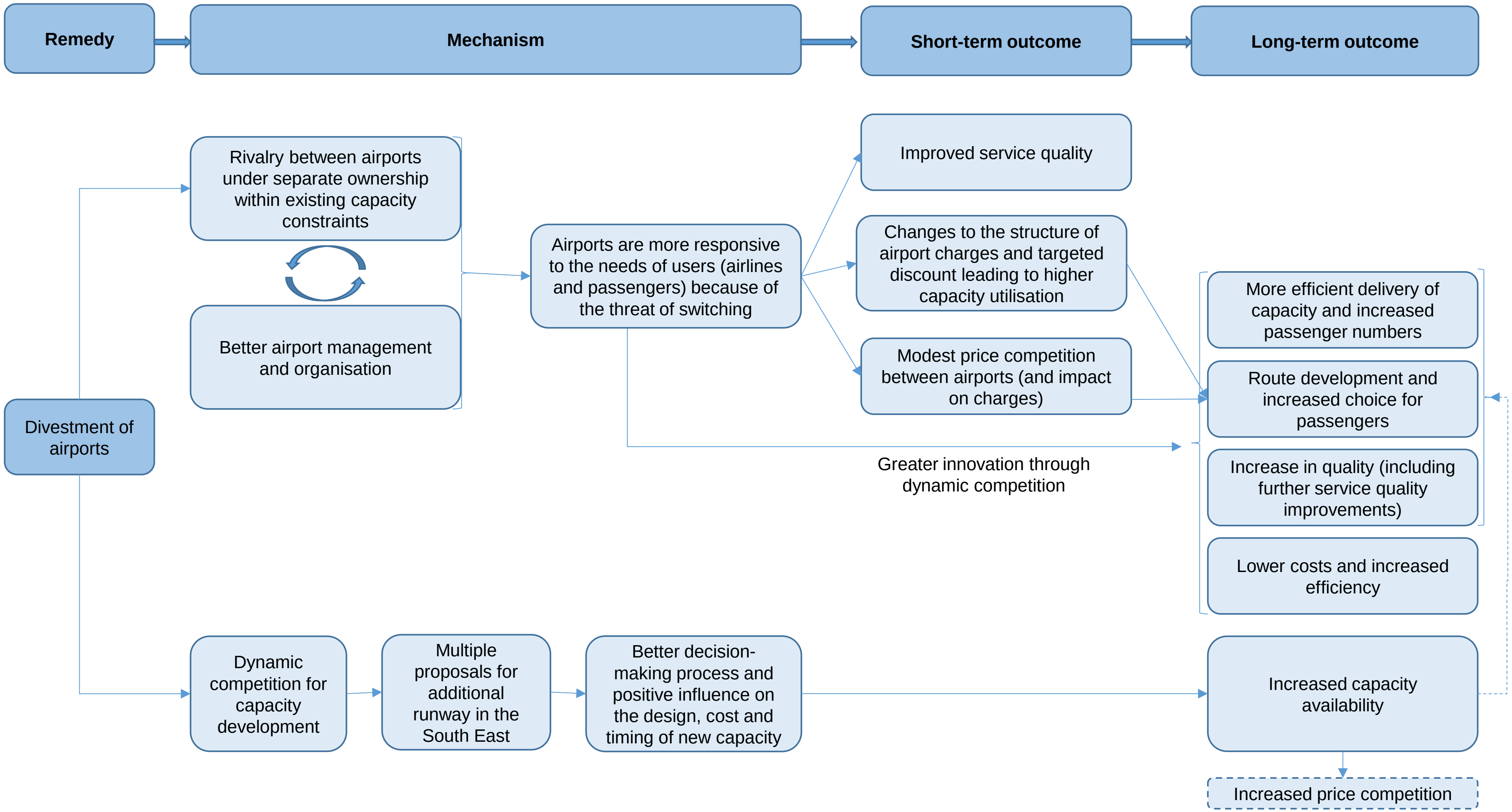
Source: CMA analysis of CAA data.
Note: Chart includes Heathrow, Gatwick and Stansted which were BAA's airports in London at the time of the 2009 investigation. We note that in the South-East there are other airports, for example London City, Luton and Southampton.

3.26 The CC envisaged that the timing of benefits from competition driven by the remedies would vary according to type of benefit and whether capacity expansion was a relevant factor. Although some increase in competition between BAA's London airports was expected within existing capacity constraints, much of the benefit envisaged by the CC was based on the expected future development of up to two additional runways in the South-East. This in turn was expected to result in further increases in competition and could lead to progressive deregulation. It is clear from the 2009 report that benefits from removing common ownership were expected to increase over time as the prospect of adding capacity was realised. It was also envisaged that price controls at Gatwick and Stansted at least would be withdrawn as competition developed and that this deregulation would lead to further benefits.[35] In general the CC expected benefits to accrue over the course of 30 years, facilitated by significant investment in new infrastructure.

3.27 Figure 3.3 illustrates this difference between the short-term and long-term impact of competition between BAA's airports as anticipated by the CC.

[35] 2009 report, paragraph 5.42.

Figure 3.3: Expected impact of airport divestments in the South-East



Source: CMA summary of the CC's expectations.

3.28 As suggested by Figure 3.3, the CC considered that the following benefits might arise from separation of common ownership, better airport management and increased competition in the South-East:

(a) Improved service quality at Stansted, Gatwick and Heathrow because separately owned airports would be more responsive to users' needs than BAA as a common owner.

(b) Modest prices decrease (in the short run) in the form of discounts to airlines and rebalancing of airport charges between landing and per-passenger charge and/or rebalancing peak/off-peak landing charges. The CC considered that in this way airports could increase volumes and develop new routes which was not in their incentive under common ownership given that increase in passenger numbers at one airport would have cannibalised sales at another airport. The main reason why the CC considered that the impact of competition on the level of prices would be modest in the shorter run was the constraints imposed by capacity shortages.

(c) Greater innovation and rivalry through dynamic competition and the adoption of differing commercial strategies which would increase choice and quality in order to attract users. The CC considered that competition would reveal opportunities to win business through superior and innovative design, lower costs, higher quality, greater flexibility and more efficient delivery of capacity.

(d) Greater incentives for capacity expansion and a better decision-making process about additional capacity. The CC considered that competition between airports and multiple bids would have a positive influence on the design, cost, timing and allocation of new capacity in the South-East. The CC also considered that users may experience additional pricing and quality benefits in advance of capacity roll-out as airports would compete to attract new airlines or prevent loss of incumbent airlines in anticipation of an increase in capacity.

3.29 In Scotland, the CC anticipated that the divestment of either Glasgow or Edinburgh and hence the increased competitive interaction between these two airports would result in discounted prices, new routes at both airports, service quality improvements and capacity development. With respect to Aberdeen, the CC considered that the behavioural remedies as described in paragraph 3.21 would provide increased transparency and improve the consultation process between airlines and the airport, making Aberdeen more responsive to the needs of its users.

3.30 For further detail on the CC's expectations, including those related to the recommendations about regulatory changes and government policy, see Appendix 2 of this report.

3.31 The CC's expectations served as a starting point for our evaluation, as illustrated by Figure 3.3 of our report and the intervention logic model on page 2 of ICF's report. However, we kept an open mind to identifying any unintended (positive or negative) consequences of the remedies throughout the evidence gathering process and analysis.

3.32 When considering remedy benefits it is relevant to note that in the seven years since the CC's investigation, contrary to prevailing expectations at the time of the CC's final report, no new runways have been approved in the South-East. In this evaluation it has not been possible to quantify how much greater the impact of the CC's remedies would have been had the expected runway expansion taken place. It is reasonable to assume, however, that the role the CC's remedies have already played in driving competition for the benefit of passengers since 2009 would have been greater in the presence of this key enabling factor.[36] This is both a view from the CMA and a view expressed by nearly all the stakeholders we interviewed as part of this evaluation study.

[36] The location of runway development is outside the scope of our evaluation.

4. Changes in the market since the market investigation reference

4.1 In this section we first briefly consider the environment within which airports operate and then summarise some of the characteristics of the UK airports market that have changed since the OFT study in 2006 and the CC market investigation that concluded in 2009.

4.2 Some of the market developments relate closely to the CC remedies, in that they were stimulated by the changes in airport ownership and the other CC interventions. Other influences that are less related to the CC's influence, or have no link at all to the CC's remedies, have also contributed to changes in the sector. Separating out the impact of the various developments and identifying their combined or inter-related influence is a difficult task. In this section we seek to provide an overview of the main changes in the market, without quantifying, attributing or prioritising their impact. Section 5 discusses evidence gathered on changes that we consider to have been influenced specifically by the CC's remedies.

4.3 We also provide summaries of trends in passenger numbers and service quality measures for selected airports.

4.4 This section is a high level summary of influences on market trends since the OFT/CC work on the sector. More detail is available in ICF's report[37] and in Oxera's report[38] for Gatwick.

Airports' environment

4.5 Airports, airlines and passengers are linked by a number of interdependencies. Airport charges and the quality of airport services can directly affect airlines' demand and behaviour while they only indirectly affect passengers via airlines' routing decisions and fares. At the same time, the demand for airport services by airlines is derived from passengers' demand for flights to and from a given airport which can be influenced by, for example, the location and connectivity of the airport, surface access or non-aeronautical services (eg car parking facilities, retail offerings, quality of lounges). In addition, passenger experience depends on other services associated with

---

[37] CMA case page.

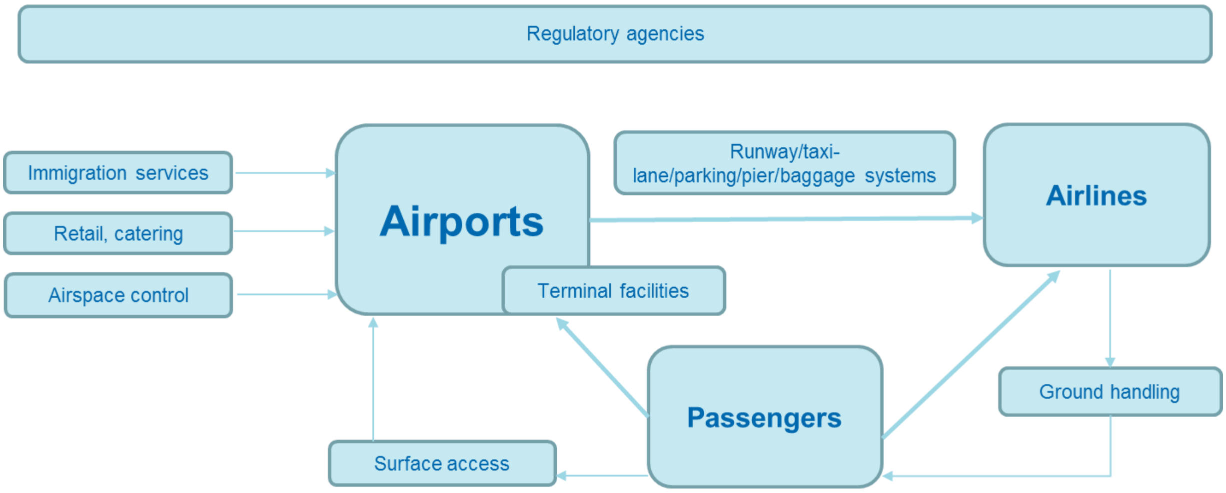
[38] *Evaluation of the Competition Commission's BAA airports market investigation*, prepared by Oxera for Gatwick in January 2016 (Oxera report for Gatwick).

airports, such as immigration services and ground handling, which may not be in the direct control of airports.

4.6 Another important consideration is the regulatory environment affecting airports. Airport services are characterised by high fixed and sunk costs and large economies of scale in the operation of (individual) airports which create entry barriers. This, together with consumers' general preference for nearby airports can give a degree of market power to airports. As a result, some airports are subject to economic regulation to protect the interests of airport users. In addition, airports are also affected by airspace restrictions, air traffic control and safety regulations.

4.7 Figure 4.1 summarises the complex environment described above and illustrates how airports' performance and passengers' perception of airports' performance can be affected by several factors and actions of multiple stakeholders. This provides helpful context for understanding the impact of the CC's remedies and other factors that might have affected airports' performance and outcomes in the market. In order to further illustrate this, we set out the main influences on market developments below.

Figure 4.1: Illustration of the environment in which airports operate



Source: CMA.

Influences on market developments

4.8 The following paragraphs set out the main developments and trends that have affected the aviation sector in the UK in the past decade.

Economic factors

4.9 Macroeconomic trends: The UK and international market for air travel is strongly influenced by macroeconomic conditions. At the time of the CC market investigation in 2009 economic conditions were challenging. Economic growth rates fluctuated for a few years following the market investigation before starting to recover in the beginning of 2013. These economic conditions affect passenger numbers and route developments, and they have implications for other factors such as fuel prices that play an important role in airlines' operations.

4.10 Fuel prices: Variations in fuel prices, and to a lesser extent exchange rates, have a significant influence on airline profitability and are also likely to affect passenger air fares, route availability and flight frequency, especially to destinations where airline profitability is marginal. Recent oil price changes have also had a direct impact on Aberdeen Airport given its dependence on the oil industry.

Airline market developments

4.11 Market liberalisation: The US-EU open skies agreement that came into effect in March 2008 has removed restrictions on flights to the USA. This in turn has influenced decisions of a number of airlines that operate from London to the USA and has affected airlines' choice of airport within the South-East. This ended the exclusive right granted for only two US airlines and two UK airlines to fly transatlantic services out of Heathrow.

4.12 Airline consolidation, entry and exit: A number of airlines have merged or been acquired during recent years. The most striking example is probably the International Airlines Group (IAG) consolidation of British Airways (BA), Iberia, Vueling, BMI and Aer Lingus. Other European examples include Air France and KLM. There have been examples of airlines entering new markets or experiencing significant growth, as well as some airlines having contracted or even ceased operations due to the difficult economic conditions. LCCs such as Ryanair and easyJet have continued to grow. Airlines such as Norwegian and those from the Middle East (eg Qatar, Emirates and Etihad) have increased their market share and now operate from multiple UK airports. An example of airline exit is Bmibaby which no longer exists.

4.13 Airline competition/service differentiation: There is now more competition between LCCs and full service carriers than historically, with many examples of reduced differentiation of service offering between these operating models, particularly on short-haul routes. Examples of the reduced differentiation in service include lower availability of in-flight meals on full service carrier services and premium seating, fast-track boarding and luggage allowances on LCCs.

4.14 Airport competition for airlines: The intensity of airport competition is a core part of this study. The airline industry is now more flexible regarding the allocation of aircraft to routes and bases used. This is particularly the case for airlines that operate multiple bases which allow aircraft on more marginal routes to be redeployed to routes operating from alternative bases. This increased flexibility of airlines, particularly low cost airlines has facilitated increased competition between airports to attract and retain airlines, not just in the South-East of England and lowland Scotland where the CC remedies were targeted, but throughout the UK and Europe.

4.15 It has not been possible during this evaluation to assess with confidence how BAA would have revised its approach and strategy in light of these developments in the absence of the divestment remedies.

Regulatory and political influences

4.16 Regulatory changes: The regulatory landscape in the UK has evolved since the CC's market investigation. Legislation was passed in the form of CAA12 and this has led to more flexibility than under the previous regulatory framework over which airports are regulated and the form of this regulation, including the length of the price control period.[39]

4.17 Political developments: There have been policy changes affecting the sector partly arising from the period of coalition government. This has led to, for example, a reversal of the previous opposition to runway capacity development in the South-East. Political interest in the sector has also surfaced as a result of airport and airline performance during events that have significantly affected aviation operations but also as a result of increased focus on environmental issues. This includes contingency planning and reaction times to events such as snow and flooding, as well as the challenges presented by the volcanic ash cloud resulting from the eruption of Iceland's Eyjafjallajökull volcano in 2010. There have also been changes in the European market, with changes to the regulations governing state aid provided for regional airports and airlines.

4.18 New capacity development: Awareness of the potential benefits and downsides of the runway development options in the South-East has been high. This has provided a platform for strong community and political engagement to consider the merits of the proposals and their likely impact if

[39] As some of these changes had been influenced by the CC's market investigation, this area is covered in greater detail in Section 5.

approved. This has led to widespread media coverage and hence public awareness of this particular debate.

Technological advances

4.19 The market is adopting new technological advances to benefit customers, such as wider use of smart phone apps, e-boarding cards, social media communication and automation of features such as check-in facilities. Increasing use of social media has raised awareness of service levels at airports and those of airlines. This has led to airports and airlines focusing efforts to avoid negative coverage and promote positive aspects of their offers.

4.20 Price/service comparison tools: The rise of price comparison websites[40] has enabled passengers to make more informed choices based on the fares they would incur and route availability or connections that can be made from different airports. There have also been technological developments in aircraft design (for example size and fuel-efficiency developments) which could have had an impact on airlines' fleets and the routes they operate.

Other influences/developments in the market

4.21 Security and immigration: There have been changes to the provision of security and immigration services, including features such as scanning of liquids in hand luggage and electronic gates at passport control. These changes have a significant bearing on the passenger experience and the time that passengers spend before and after flights at an airport.

4.22 Transport connections: Passenger choice and the extent of airport catchment areas are heavily influenced by the relative ease and price of transport links to the airports. Whilst there are no significant examples of change since 2009, future projects such as Crossrail and HS2 will influence the market in London and beyond.

4.23 Airport charges: The Airport Charges Regulations introduced in 2011[41] implement the EU Directive on this subject. The Regulations provide a common framework by which UK airports consult their airline customers about airport charges, service level agreements and major infrastructure projects. There is also a requirement not to discriminate between airport users. The regulations currently apply to nine UK airports each with more than five million

[40] Some of these online platforms are under investigation by the CAA relating to their price transparency.
[41] Statutory Instrument 2011/2491.

passengers a year and are on a similar basis to the CC's remedies for consultation that were devised for Heathrow and Aberdeen.

Market trends for passenger numbers and service quality

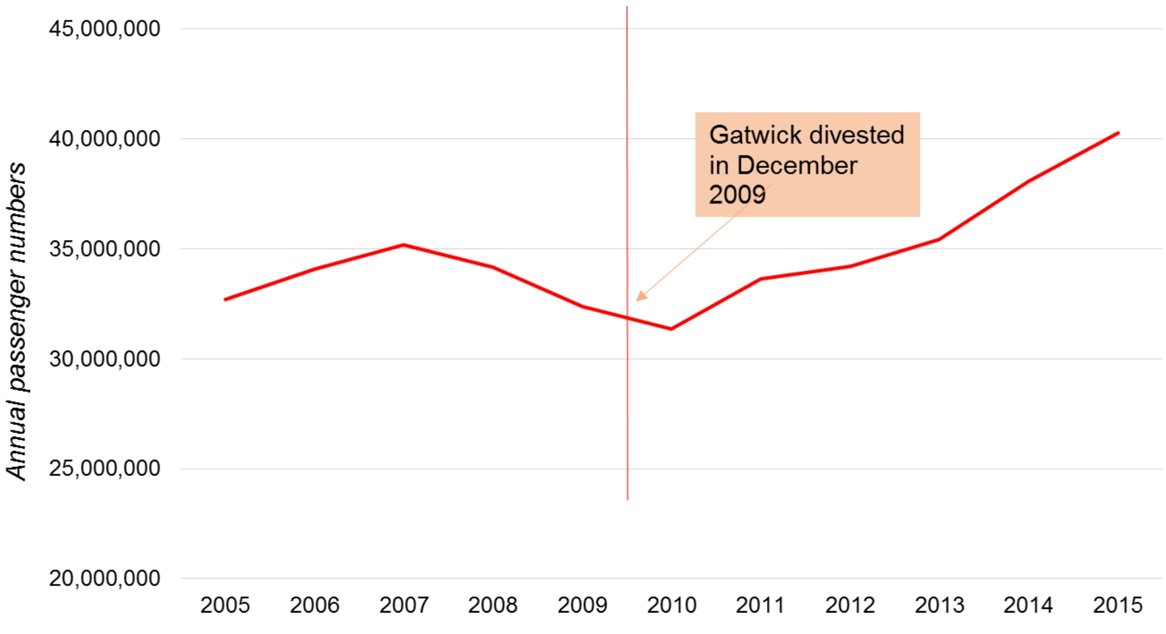
4.24 In the following paragraphs we give a brief overview of trends in passenger numbers and service quality at the largest UK airports to provide context for the evidence presented in Section 5.

4.25 In reviewing these trends, where possible it is useful to distinguish developments at the divested airports (Gatwick, Edinburgh and Stansted) and Heathrow from those in the wider airports market.

Passenger numbers

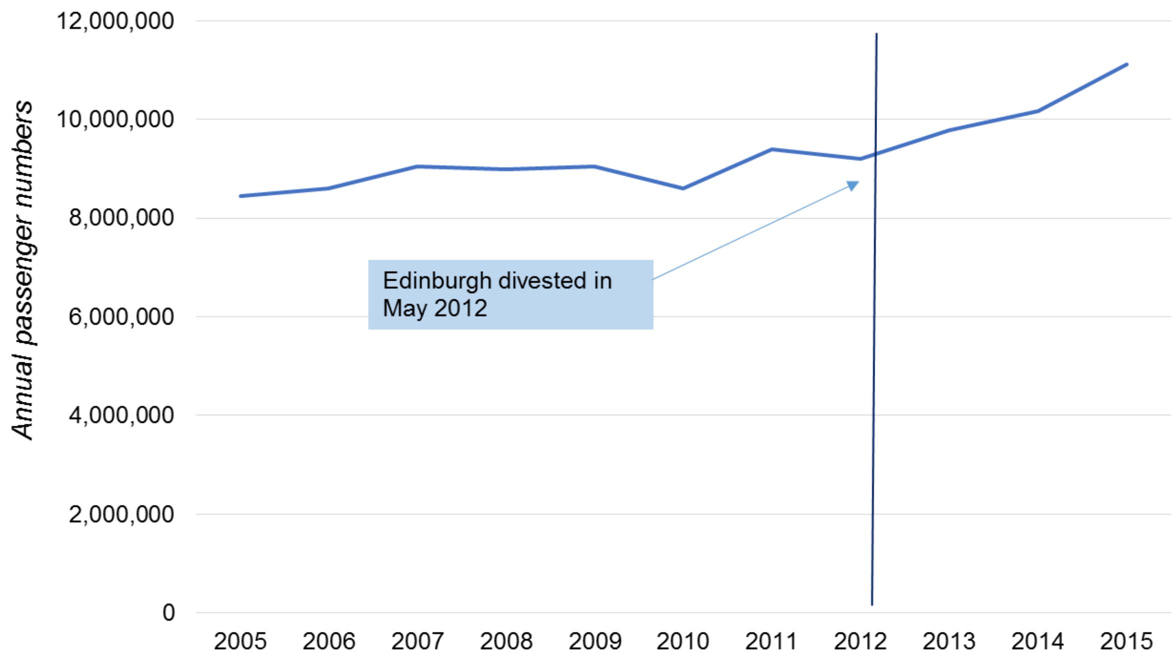
4.26 There has been significant growth in passenger numbers in the sector since the competition landscape was influenced by the CC remedies. It is likely that other factors will have contributed to this, not least the performance of the economy. Figures 4.2 to 4.4 show the passenger throughput trends at the three divested airports since 2005.

Figure 4.2: Passenger volumes at Gatwick



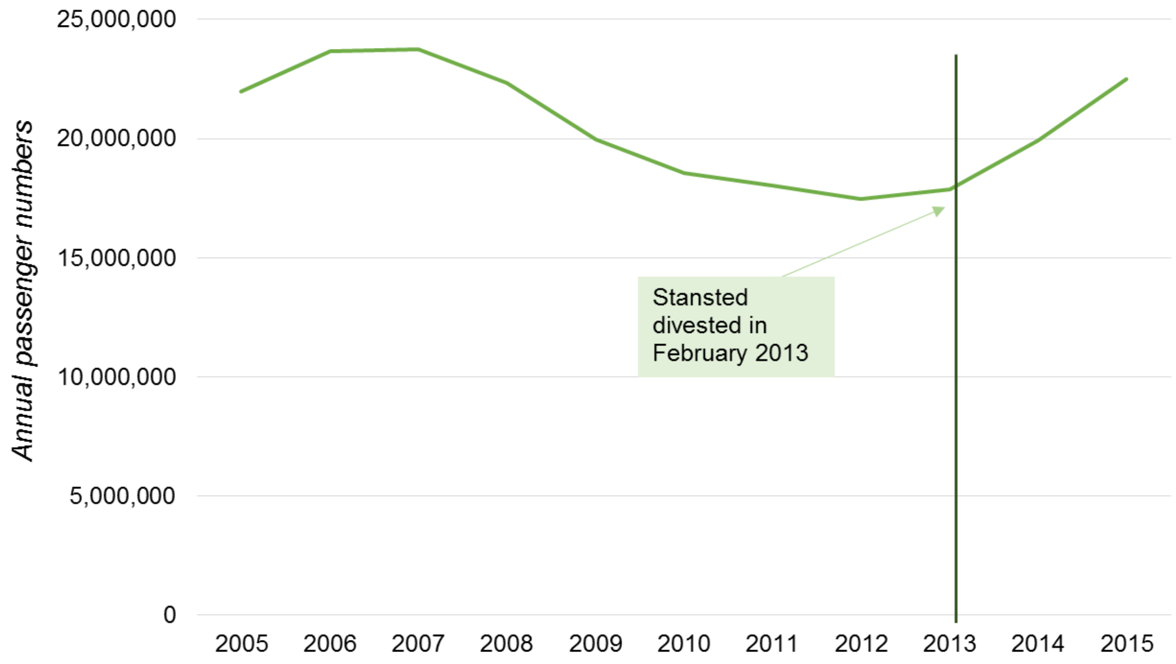
Source: CMA analysis of CAA terminal and transfer passenger data.

Figure 4.3: Passenger volumes at Edinburgh



Source: CMA analysis of CAA terminal and transfer passenger data.

Figure 4.4: Passenger volumes at Stansted

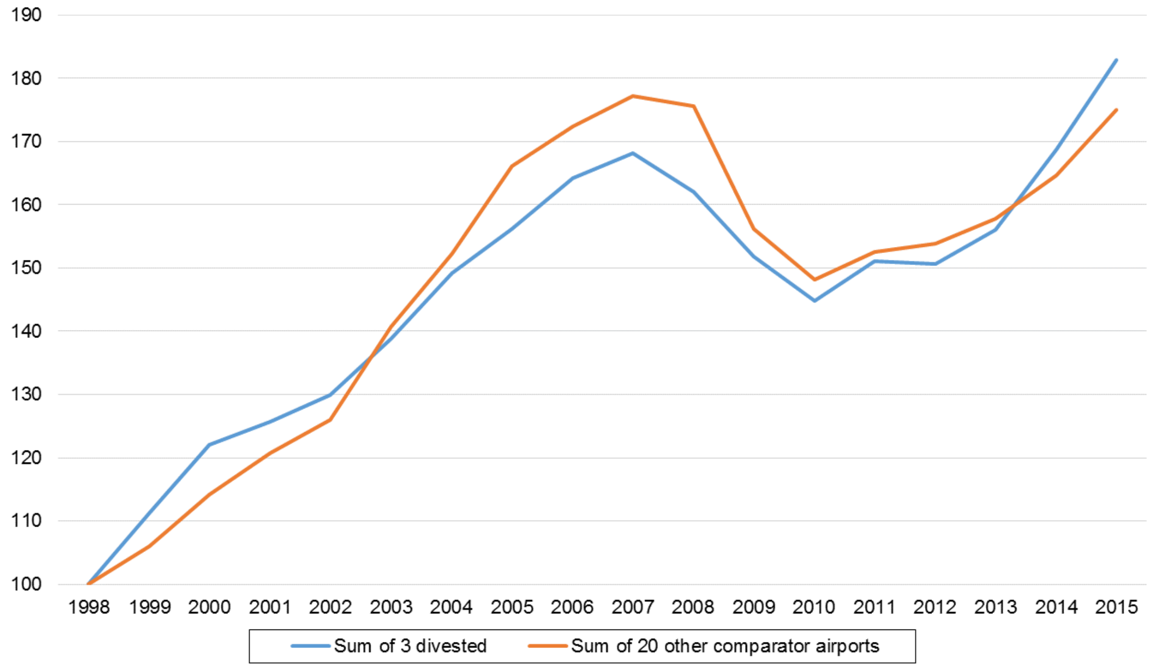


Source: CMA analysis of CAA terminal and transfer passenger data.

4.27 These charts reveal a noticeable step change in the volume of passenger numbers using the airports at the time of their divestments, in all three cases.

4.28 Figure 4.5 shows the longer term trends in passenger numbers at the three divested airports compared with the wider UK airports sector, as represented by the largest 20 comparator airports. This shows that since early 2012 the divested airports have experienced passenger growth at a rate higher than comparable UK airports.

Figure 4.5: Long-term passenger volumes trends



Source: CMA analysis of CAA terminal and transfer passenger data.

Service quality

4.29 Table 4.1 shows trends in passenger satisfaction based on ASQ data[42] since the CC interventions at the divested airports and at Heathrow.

Table 4.1: ASQ scores of passenger satisfaction, converted to %

	2009	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*
Gatwick	75.2	76.6	76.8	78.0	79.4	80.1	80.4
Edinburgh	79.0	79.9	82.0	83.8	82.0	82.1	81.4
Stansted	75.2	75.5	74.7	75.2	75.1	72.5	71.6
Heathrow	75.6	76.8	77.5	78.7	79.5	80.8	82.3

Source: CMA analysis of ASQ data provided by airports.

[42] ACI is the global trade representative of the world's airports. ACI's ASQ is the global benchmarking programme measuring passengers' satisfaction whilst they are travelling through an airport. The ASQ programme provides management information to better understand passengers' views and what they value from an airport's products and services. The ASQ survey covers a range of 34 key service areas including: check-in and security; wayfinding; cleanliness and quality of the airport; ambience, helpfulness of staff; cleanliness of washrooms; comfort of waiting areas and lastly quality, availability and value for money of restaurants and shopping facilities. All participating airports use the same survey questions to create an industry standard set of responses that allows airports to track and assess their airport's performance, as well as benchmark results against airports in their local market and globally. List of full participants are available on ACI's website.

4.30 Table 4.1 shows that Gatwick's service quality score has been steadily increasing since the divestment and so has Heathrow's score since 2009. Heathrow and Gatwick are by far the largest airports and hence a large proportion of passengers travelling to and from the UK have benefited from these notable changes. Edinburgh and Stansted have experienced a drop in service quality perception since their divestment but, as discussed in Section 5, this was caused by disruptions due to terminal reconfigurations arising from investments made by their new owners. In the longer term, this is expected to yield service improvement.

5. Impact of the Competition Commission's remedies

Outline of the section

5.1 In the following sections we set out an overview of the qualitative and quantitative evidence relating to the impact of the divestments in the South-East and in Scotland.

5.2 We start with a reference to the CC's expectations in relation to the impact of the divestments in the South-East and then review the actual developments that have taken place, including the revised focus and strategy of airports. We then discuss the consequence of capacity constraints on competition and related to this, the impact of the divestments on the process of runway capacity proposals in the South-East. We then outline benefits beyond the CC's expectations as well as possible unintended consequences of divestiture and we highlight the importance of enabling factors for the development of competition. After this we review the qualitative evidence relating to changes in economic regulation. We then discuss the impact of divestment remedy in Scotland, including a case study on Edinburgh and possible unintended consequences that have taken place. Finally we review the impact of behavioural remedies in Aberdeen.

5.3 During the evaluation we met a range of key stakeholders in order to gain a comprehensive understanding of the impact of the remedies put in place by the CC. We gathered this evidence through interviews with those directly involved with the divestment process; new owners of the airports; third parties such as airlines; government bodies and trade associations. Views of passengers are incorporated in the measures of service quality used by airports (see discussion of ASQ data below).

5.4 Where appropriate, we also refer to the qualitative and quantitative analysis carried out by ICF which provides additional insights on the impact of the remedies. ICF's work involved descriptive analysis of a range of indicators (eg passenger throughput or quality measures) and econometric modelling to identify any significant changes to some of these indicators before and after the CC's remedies at the divested airports compared with unaffected airports. Where observable and statistically significant changes were identified, ICF estimated consumer benefits arising from these changes.

Impact of remedies in the South-East

Introduction

CC expectations

5.5 The CC envisaged that following the separation of ownership, enhanced competition between BAA's airports in the South-East would develop over time. As set out in Section 3, the CC considered that competition between these airports would result in better ways of delivering capacity, improved service standards, wider choice, greater innovation and pricing benefits, albeit these pricing benefits would be modest in the short run. It also anticipated changes at Heathrow but noted that the competition developments here may be different due to its hub status and limited spare capacity. In paragraphs 5.8 to 5.99 we consider qualitative evidence from stakeholders and quantitative analysis from ICF to assess whether actual developments in the market have been in line with the CC's expectations and other developments not envisaged by the CC. We then summarise our main findings in paragraph 5.100.

Additional influences

5.6 In discussing the improvements seen in the sector since the divestments, we were aware that there had been other factors influencing progress. The main developments that could have affected the UK aviation sector since the market investigation besides the CC's remedies are briefly summarised in Section 4.[43]

5.7 While it is difficult to isolate the particular impact of the CC's interventions from other market developments, it is clear from the detailed evidence summarised below, that the divestments that generated separate ownership and resulting increase in competition were probably the most significant catalyst and reason for change in airports' strategies and performance. This is also supported by the econometric analysis of ICF, discussed in paragraph 5.87, which shows that the increase in passenger throughput at the divested airports has been significantly higher than at the unaffected airports after divestment.

[43] For more detail see Section 2.4 of ICF's report and Section 4 of the Oxera report for Gatwick.

Impact of revised focus and strategy of airports

5.8 Since the CC remedies were implemented new management teams have introduced fresh commercial strategies to develop and operate Heathrow, Gatwick and Stansted. It is clear from the evidence we have gathered that these new management teams are all keen to compete to be successful and in particular show strong drive to meet passengers' service expectations. While each airport has different priorities and challenges, they are all striving to seek continuous improvement and some service differentiation through innovation.

5.9 Both Gatwick and Stansted, together with their respective owners, Global Infrastructure Partners (GIP) and Manchester Airports Holdings Limited (known as MAG), told us of the contrast between their operations when owned by BAA and their new freedom after the divestments. They described the period of BAA ownership as one where they felt they were not a priority compared with Heathrow. In particular, they mentioned poor airline and community relationships and a general lack of appetite for innovation and risk-taking to drive forward service differentiation and service improvement.

5.10 In addition to Gatwick and Stansted, Heathrow has been affected by the remedies. All three airports can point to initiatives to deliver service improvements, process changes to avoid unnecessarily high capex and new commercial arrangements with airlines. Gatwick and Stansted told us that the divestments had triggered revised strategies that would not have occurred if common ownership had been retained. Heathrow pointed to a number of factors including the remedies themselves that had led to changes in the market. An important factor it highlighted was its change in management strategy. These changes are summarised below.

5.11 When considering the views of divested airports we are aware that some caution may be needed. It could be argued that an element of self-interest could be behind comments which contrast operations before and after the divestments. With this in mind we aimed to interview as broad a range of stakeholders as possible in order to attain different opinions. We found that views from other stakeholders generally concurred with the opinion of divested airports. The views of airlines, non-affected airports, government bodies and an independent market observer are also summarised below.

5.12 It is also apparent that the affected airports have been able to achieve progress in operational performance and customer satisfaction in a relatively short period since they were divested by BAA.[44] In the following paragraphs we outline the evidence showing this with particular focus on the change in approaches and new initiatives observed.

Gatwick

5.13 Gatwick considered that under BAA ownership there had been a high degree of centralisation in terms of decision making and the development of commercial strategies. This included the central dictation of how each airport was used and the allocation of airlines and flights to each airport. To illustrate this Gatwick told us that before divestment it was not represented at the slot allocation conferences which took place every six months. Under new management Gatwick is actively competing with other airports to retain existing routes and secure new routes, airlines and newly commissioned larger aircraft.

5.14 Gatwick referred to a number of initiatives that it considered would not have developed had BAA retained ownership. Gatwick provided examples of innovations to improve the passenger experience and allow the airport to compete with rivals. These are summarised below.

Commercial agreements with airlines

5.15 Gatwick referred to the Contracts and Commitment framework which had replaced traditional RAB[45] based regulation, enabling contracts to be agreed with individual airlines using Gatwick. This involved bespoke commercial arrangements with airlines and defined guaranteed service standards with rebates for failure of the defined service levels. Over 80% of passengers are now covered by such arrangements under the Contracts and Commitment framework.[46] Gatwick said that its commitments to all airline users, contained in the airports' Conditions of Use and supported by the ultimate backstop of the economic licence arrangements with the CAA, provide for price protection and good service provision for all users. In addition to that, Gatwick's Contracts initiative enabled it to create bespoke arrangements with individual airlines and thereby deliver services more tailored to the needs of particular

[44] This is despite the fact that some of the changes could not be made immediately after the divestments. For example, Gatwick pointed out that its divestment took place in the middle of the Q5 price control review period. This meant that it had already agreed investments for the control period and hence it was difficult to respond immediately to the change in the competitive setting. See Oxera report for Gatwick, p40.
[45] Regulatory asset base.
[46] Gatwick noted that in addition to the Contract and Commitments framework all airlines, serving 100% of passengers, are covered by the airport's conditions of use. These define the services offered, the charges, and the obligations on airlines for use of the airport. Some small airlines or those not frequently using Gatwick do not have their own individual contracts.

airlines and their passenger groups. Gatwick's pricing strategy under the commitments regime had delivered yields that were below the CAA's 'fair price' benchmark. More specifically, Gatwick's blended yield (that is, the post-discount yield actually achieved by Gatwick) was 5.8% below the CAA benchmark in 2014/15 and is expected to be 6.3% and 3.8% below the benchmark in 2015/16 and 2016/17 respectively.[47] Gatwick also pointed out that as part of the contracts and commitments regime it had agreed to invest, on average, at least £100 million a year, without specifying the projects in advance, as had been the case in the previous regulatory regime. The ability to make agreements with individual airlines and to update the capex programme to suit the changing needs of users has made it easier to agree capex.[48] Paragraph 5.19 below set out more detail on the revised capex programme of Gatwick.

Capacity generation within existing infrastructure

5.16 Gatwick told us that it had generated extra capacity within existing infrastructure and managed to increase peak aircraft movements per hour from 50 to 55 since the change in ownership.[49,50] It referred to a new pricing structure as the main initiative taken to incentivise more efficient use of airport infrastructure to realise additional capacity. In particular, Gatwick had sought to encourage efficient use of its facilities at peak times and develop traffic at off-peak times.[51,52] Gatwick expressed a view that BAA did not have a material incentive to maximise the capacity of the airport as any unserved demand would probably have been diverted to Stansted so continuing to contribute revenue to BAA. It added that Gatwick now had an incentive to

---

[47] See Oxera report for Gatwick, p45.
[48] Oxera report for Gatwick, p53.
[49] See Oxera report for Gatwick, p60. Aircraft movements include take-offs and landings.
[50] Gatwick noted it was operating at near full capacity and hence was seeking approval to construct a second runway.
[51] Gatwick introduced lower winter charges, with no landing fees, only passenger charges to encourage more winter flights. A new charging structure for the peak summer periods was developed to encourage larger and fuller planes. This is based on increased summer landing charges and decreased passenger charge, particularly for 'super-peak' early morning summer departure slots. Other examples of changes in the structure of charges are listed in Oxera report for Gatwick, p48.
[52] Flybe told us that the changes Gatwick made to its airport charges could negatively affect regional operators and regional connectivity. This was because the new structure was more favourable to larger aircrafts and meant a significant charge increase for aircrafts with less than 140 seats. As a result of the changes in charges, Flybe had to withdraw most of its operations form Gatwick. We note that Gatwick's decision to increase its summer landing charges in 2011 led to a challenge to the CAA by Flybe which claimed that this change in tariff structure was anti-competitive and discriminatory under the Airports Act 1986. In 2012, the CAA determined that: 'although GAL's increased landing charges discriminated against users of small aircraft, the discrimination was not unreasonable as GAL's objective in re-structuring its charges of increasing the efficient use of its single runway justified its decision to make the changes challenged by Flybe...The CAA considers that some passengers may be harmed by GAL's changes to its charging structure. However, the CAA's conclusion is that the numbers involved are likely to be small and the adverse effects would be balanced by benefits to other passengers.' See CAA (2013), 'Investigation under Section 41 of the Airports Act 1986 of the structure of airport charges levied by Gatwick Airport Limited – CAA decision', 17 January, paragraphs S2 & S5.

both maximise capacity and to compete with Heathrow and Stansted for new services to and from London.

Route development

5.17 Gatwick referred to various examples of airline growth and route development. It cited the rise of Norwegian which was now offering long-haul flights in direct competition to other airlines such as BA from Gatwick. It considered that such competition would not have prevailed under BAA since the routes would have been allocated centrally to each individual airport. Gatwick pointed to a quote from Norwegian to illustrate this: 'Under BAA, NAS (Norwegian) was a smaller player and didn't get any attention. BAA's whole focus was on the base carriers. BAA's approach was "this is what we have, take it or leave it". It has noticed dramatic changes in attitudes and improvements since new ownership at Gatwick.'[53] More generally, Gatwick has been actively seeking to attract new long-haul services from Heathrow. An example of this is the long-haul incentive scheme that Gatwick introduced after the divestment.[54] In order to share the start-up risk with airlines when establishing new routes, Gatwick offered discounts to airports on charges in the first years of operation. This scheme was then replaced by the current contracts and commitments initiative as mentioned above.

5.18 Gatwick told us that it had also developed a pipeline of target airlines and routes, expanded its airline relation team and improved its access to aviation data to help with airline and route business case presentations.[55] As a result, since 2009, existing carriers such as easyJet, BA, Emirates and Virgin have increased capacity at the airport and Norwegian transferred from Stansted. New carriers, such as Turkish Airlines, Icelandair, Vueling, Swiss, WestJet and Cathay Pacific have entered, while carriers such as Air China, Garuda Indonesia, Korean Air and Vietnam Airlines have entered and exited.[56] The benefits of route development are illustrated by the example highlighted by GIP: GIP's analysis shows that when easyJet launched the London-Moscow route from Gatwick competing with BA's existing service from Heathrow, overall passenger numbers almost doubled on this route and fares decreased significantly.

---

[53] CAA (2013), 'Appendix E: Evidence and analysis on competitive constraints: Airlines' CAP 1134, paragraph E201.
[54] See Oxera report for Gatwick, p47.
[55] See Oxera report for Gatwick, p22.
[56] Ibid.

Revised capex programme and increased efficiency

5.19 Gatwick told us that after its sale, it undertook a detailed review of the BAA capital investment programme and identified cost savings by delivering projects which differed from those that BAA had planned.[57] Gatwick's new mind-set centred on efficient capex and focused on process improvements as an alternative to unnecessary large capex. As an example, Gatwick referred to changes it had made to the layout in security and check-in, which had reduced the need for capex since it had avoided the need to expand the terminal. Previously there had been three separate smaller security areas. Process innovations had allowed this to be consolidated into one location with the only compromise being the loss of some landside retail space. Gatwick said that these process improvements had reduced bottlenecks, improved the customer experience of passing through security to enter the departure lounge[58] and reduced travel time through the security area by 25%.[59] Gatwick also pointed out that there was no allowance in Gatwick's Q5 price control review settlement for the £45 million cost of this development or the foregone commercial revenues from the disruption. Gatwick decided to fund the costs from capital efficiencies made after the break-up rather than wait until the next regulatory control period when an allowance would have been made for the lost revenues.[60] Another example of Gatwick's revised capex approach was its development of its pier service in the North Terminal, saving more than £200 million and providing operating efficiency benefits for airlines.[61]

5.20 Gatwick has also made targeted investments requested by particular airlines such as the ongoing terminal moves and transformation programme which will allow individual airlines to operate from a single terminal instead of having their operation split across two. Gatwick expects this change to result in an increase of the operational efficiency of the airport and airlines and will reduce confusion for passengers.[62] See the case study at Figure 5.3 for further detail.

Service improvements related to security checks and check-in

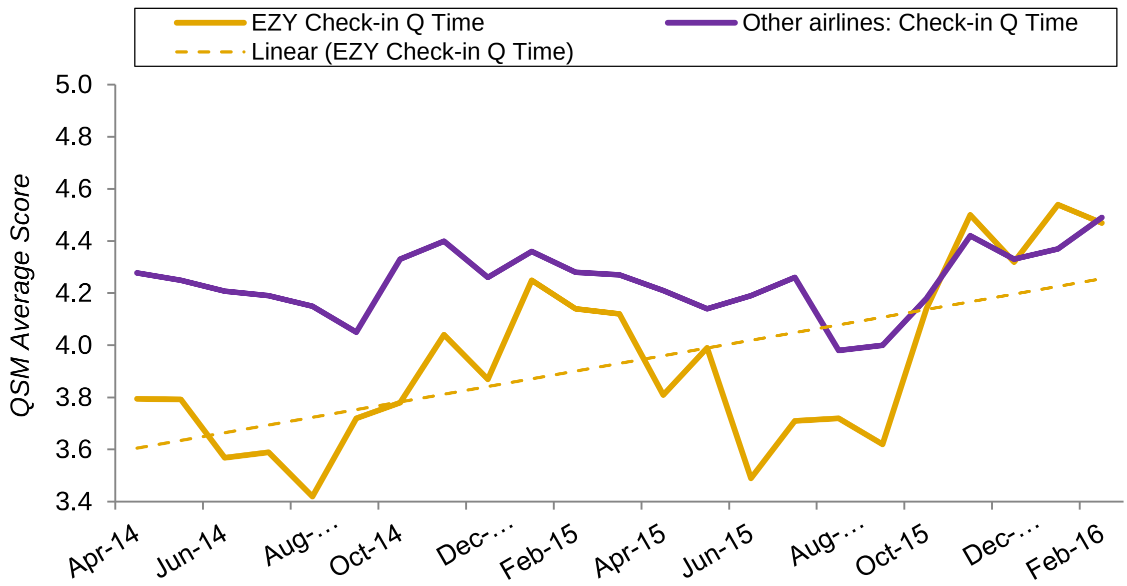
5.21 In addition to the example mentioned in paragraph 5.19, a further initiative that Gatwick highlighted was bag drop automation at check-in facilities. Gatwick had partnered with specific airlines to improve facilities for passengers to check-in their luggage and this had led to lower queuing times

---

[57] Oxera report for Gatwick, p53.
[58] See the steady increase in ASQ passenger satisfaction score for waiting time at security inspection for Gatwick in Annex 3 of ICF's report (Figure A3.2).
[59] See Oxera report for Gatwick, p42.
[60] Ibid, p42.
[61] Ibid, p53.
[62] Ibid, p54.

for passengers. Figure 5.1 illustrates an example of how improvements have been made for queue times at check-in after self-service check-in terminals were installed for easyJet passengers in October 2015.[63] Gatwick said that queuing times had been particularly improved at off-peak periods. Prior to changes, there had been a high risk of delays as staffing levels at manual check-in desks would have been lower at off-peak periods. In addition to passenger benefits, Gatwick told us that airlines had benefited from lower operating costs through this automation of check-in facilities.

Figure 5.1: Gatwick North Terminal queue time at check-in



Source: Gatwick.

5.22 Other examples of innovation related to security checks and check-in highlighted by Gatwick include:[64]

- Implementing new security technology and processes to speed up the flow of passengers and make more efficient use of staff in the South Terminal (Gen II Security Programme) in May 2015. As a result, the number of passengers per hour per lane increased from 160 at the time of the divestment to 600 by December 2015. This security technology is also being introduced in the North Terminal in a programme from February to September 2016.

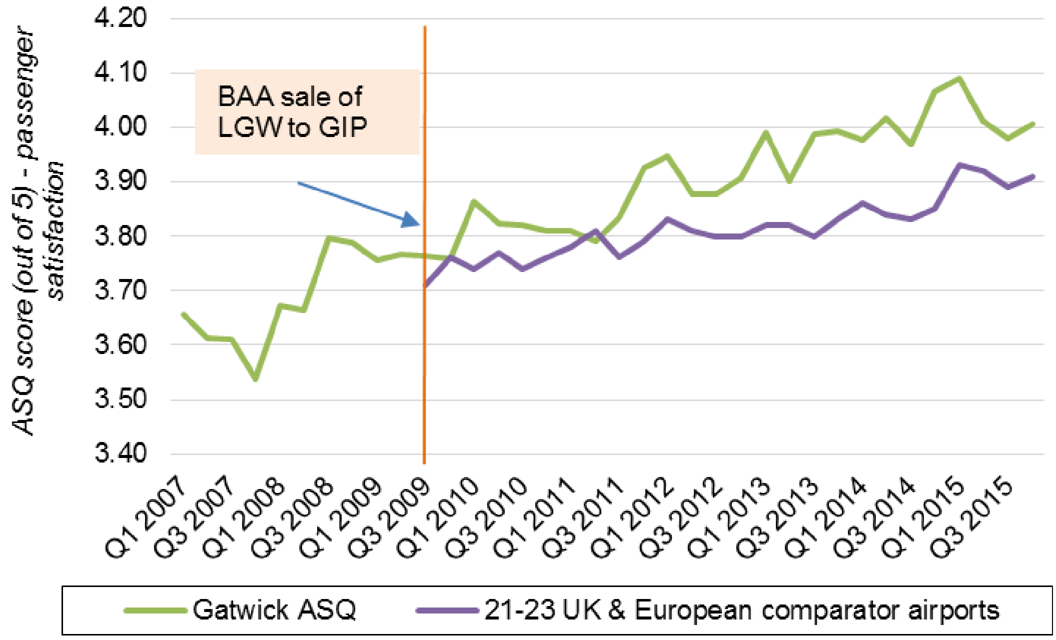
[63] See also the steady increase in ASQ passenger satisfaction score for waiting time in check-in queue/line for Gatwick in Annex 3 of ICF's report (Figure A3.2).
[64] See Oxera report for Gatwick, pp42 & 43.

- Introducing assistance lanes for security screening for passengers with reduced mobility and families with young children with different service needs than those standards required by regulation. Gatwick told us that it was the first among UK airports to implement this approach which was then also adopted by Heathrow.

- Introducing GatwickConnects, a service that aims to improve the service offering for airlines that wish to exploit the connecting market but do not have the capability to offer these services themselves.[65] It is also intended that GatwickConnects will enable Gatwick to compete with Heathrow's offer for transfer traffic.[66]

5.23 The impact of these innovations and improvements is reflected in increased service quality scores at Gatwick. Figure 5.2 shows how Gatwick's passenger satisfaction has improved since the change in ownership, comparing Gatwick's ASQ scores with comparator airports in Western Europe.[67] This shows that since the start of 2014 the level of satisfaction has been over 80% at Gatwick.

Figure 5.2: Gatwick's passenger satisfaction vs Western European comparator airports



Source: CMA analysis of ASQ scores provided by Gatwick.

---

[65] The connecting market is where passengers change planes in an airport. Passengers travelling with airlines that do not offer connecting services are required to collect bags from their arriving flight and check-in for the connecting departure.
[66] See Gatwick's website.
[67] Comparator airports are those with passenger numbers above 15 million a year. Gatwick does not hold data for comparator airports from the time of BAA ownership.

Rail station upgrade

5.24 Gatwick considered that previously the rail station at Gatwick had an extremely poor reputation and that it had not been welcoming or provided a good impression for passengers. It identified the rail station as a priority for regeneration in line with a new focus following the divestment to seek to capture more business customers and passengers travelling from central London (which is 30 minutes away by train). Gatwick said that it had voluntarily contributed £7.6 million to spur Network Rail to invest in a project to refresh the station and construct a 7th platform. In addition to this Gatwick also contributed another £30 million to an upcoming large scale upgrade of the station concourse and platform circulation infrastructure. Gatwick considered that BAA would not have prioritised or financially contributed to progress this rail station upgrade because business passengers were considered the target market for Heathrow and due to a desire to grow Stansted.

Air traffic control

5.25 Having altered charging structures, Gatwick's next initiative to drive efficiency and increase aircraft flows was the decision to change its incumbent air traffic control provider. Following a commercial tendering process, NATS has been replaced by German operator DFS. This new provider offered a competitive cost proposal and the transition has also offered innovative thinking on options to increase resilience and flows of airlines using the runway. Gatwick indicated that the benefits of efficiency gains would feed through to passengers in the form of lower congestion and better service. It considered the change of traffic control provider would have been unlikely to happen if BAA had still owned Gatwick because of BAA's more centralised approach regarding procurement of services.[68]

[68] Gatwick noted that the change in provider had been subject to extensive legal challenge, but despite this it had maintained its drive to switch to a new service provider.

Figure 5.3: Case study – Airline consultation, efficiency and service at Gatwick

The CC envisaged that under separate ownership airports would be more responsive to the interests of airlines. Gatwick has successfully consulted with a number of key airlines to enable its largest customer easyJet to consolidate its operations into one terminal (North Terminal). Gatwick undertook formal consultation with its top 12 airlines (representing 93% of passengers) and the Passenger Advisory Group, and announced its final decision in January 2015. To facilitate this change, BA and Virgin Atlantic have agreed to move terminals and will operate from the South and North Terminals respectively as of January 2017. Gatwick considers the move will improve the airport experience for easyJet passengers and BA and Virgin Atlantic passengers will also benefit from enhanced facilities including new check-in areas and lounges.

Illustration of planned new check-in area

The agreed airline moves are expected to increase the operational efficiency of the airport and enable easyJet to increase its own efficiency – for example by removing duplication of operational staff facilities, and reducing the number of aircraft changes required at short notice between terminals. It will also reduce confusion for easyJet passengers who will all depart and return to the same terminal. This example illustrates how Gatwick has been able to work together with airlines for the benefit of passengers.

In addition, the change in airline mix between terminals has meant that the requirement for additional capacity in Gatwick's North Terminal can be deferred for several years. Gatwick's planned Pier 6 southern extension development is now phased later in its Capital Investment Plan (CIP). This is an example of how the CC's divestment remedy and new regulatory regime have helped shift the focus of airports in favour of operational improvements rather than capex solutions. It is also an example of an airline specific improvement, as envisaged by the CC (see 2009 Final Report, paragraph 10.41(d).

Oxera's report also notes that under Gatwick's former price control regime, prices were closely linked to costs so that airlines generally tried to advance capex that benefited them, while delaying those projects that benefited competitors. Oxera notes that in contrast, Gatwick's Contracts and Commitments regime has allowed Gatwick to more easily conduct commercial discussions with individual airlines on a bilateral basis which has enabled agreements to be reached faster and more efficiently, ultimately to the benefit of passengers.

When Gatwick announced the terminal moves BA said 'This is an exciting opportunity for BA and our customers. The South Terminal has recently received significant investment to its security area and departure lounge, and we will be working with Gatwick to provide our customers with a new check-in area and lounge. The South Terminal also has direct access to trains that run to and from Central London'.

Sources: *Gatwick Capital Investment Programme* (2015); Oxera's report for Gatwick, p55; *Gatwick announcement January 2015*; *Gatwick ten year business plan* (2013).

Stansted

5.26 Stansted told us that previously it had been designated by BAA as the airport in the BAA group's portfolio which should focus on the LCC market. Stansted considered this to be a result of artificial segmentation of the market under BAA ownership. It referred to its market research which indicated that around two-thirds of passengers in the Stansted catchment area were travelling further afield to use other London airports rather than using their local airport. Stansted told us that there was no reason why Stansted should predominantly serve LCCs given the relatively affluent population in its immediate catchment as well as strong economic growth in the London-Cambridge corridor and in its wider catchment area covering central London.

5.27 Although under new ownership LCCs have grown at Stansted, the airport has also shown an appetite to grow its presence in the long-haul international market and to serve full service carriers. According to Stansted this strategy had not been prioritised during BAA ownership. Furthermore, as discussed in paragraph 5.45 below, Stansted noted its movement towards greater usage of ASQ data comparators and metrics particularly focusing on whether customers would recommend Stansted to others based on experience. Lastly, Stansted noted an increase in spending to enhance the airport's facilities under new ownership rather than to maintain them as had been the case under BAA.

5.28 In the following paragraphs we outline some of the examples cited by Stansted which characterise its new approach. This included: commercial agreements with airlines; service improvements; route development including in the long-haul international travel market; increased efficiency; improved community relations; and development of the freight cargo hub.

Commercial agreements with airlines

5.29 Stansted told us that its strategy following the divestment had been to provide the airlines using Stansted with long-term confidence that low airport charges would apply and to work with airlines with ambitious growth plans. As discussed below, improvements in passenger services has allowed Stansted to increase its attractiveness to airlines and to support airline growth. After the divestment and deregulation by the CAA, Stansted was focusing on developing bespoke commercial contracts with airlines. For example, Stansted agreed commercial arrangements with Ryanair, covering over 70% of passengers using Stansted. As discussed in paragraph 5.51, Ryanair told us that the ten-year commercial contract it had secured with Stansted may not have been possible had the airport still been owned by BAA.

Increased investment and service improvements

5.30 With respect to investment to improve the quality of services, Stansted cited the increase from around £20 million a year maintenance based spending by BAA to £60 million a year maintenance and enhancement spend, including the development of terminal and security facilities. Stansted considered this to be evidence of a mindset shift from yield driven, short-term profit maximisation (under BAA) to a focus on improving services and developing greater volumes with airlines. This investment is part of the terminal transformation programme at Stansted. MAG noted in its annual 2015 report that since it had acquired Stansted it had embarked on an ambitious project to improve the passenger experience. Stansted's £80 million terminal transformation project will double the size of the security area, introduce Stansted's first executive lounge and provide the airport with 50 new shops, bars and restaurants.[69]

5.31 Stansted also mentioned its focus on improving the passenger experience.[70] Specifically, it focused on increasing passenger volumes and providing discretionary services to them to generate commercial revenue from car parking[71] and retail. This has also allowed Stansted to increase profits through

---

[69] See MAG 2015 Annual Report, p14.
[70] For instance it noted its work with Ryanair's approach to allowing its passengers to take a second piece of hand luggage on board was first trialled at Stansted for nine months before being rolled out to other airports.
[71] When MAG acquired Stansted only 50% of the car parking facilities were used. Stansted told us that through greater use of promotional discounting for advanced booking, usage had risen (with 95% occupancy at peak times) and this was not at the expense of passengers arriving by public transport.

encouraging greater spend by passengers[72] at the airport and to use this profit to support lower charges, which benefits airlines and passengers.[73]

Route development

5.32 Stansted has signed long-term agreements with airlines that have delivered over 30 new routes and an additional 3 million passengers.[74] Stansted told us that its next stage of growth relied on Satellite One, its new departure gate area which it considered would create the conditions for full service carriers and therefore facilitate long-haul international travel. Stansted cited that through this £10 million upgrade it was developing its ability to compete with other international airports. Stansted considered that this investment was a risk as it was proceeding without agreed contracts or financial contributions from new carriers, and it was investment intended to allow it to compete for airlines presently using Heathrow and Gatwick. According to Stansted, such investment would not have occurred under BAA's ownership as Stansted was not considered a focus for long-haul international travel. An additional challenge in this area had been that some international airlines were not familiar with the airport and others had long-standing links to Gatwick and Heathrow. Stansted recognised the importance of building relationships gradually with airlines in order to develop long-haul international routes. However, this had proved difficult as no such relationships had been established under BAA ownership.

Increased efficiency from local decision making

5.33 Stansted pointed to an example of its focus on cost efficiencies relating to the transit system which shuttles passengers from the terminal to flight departure gates. BAA had plans for major investment to replace these but MAG instead embarked on a refurbishment programme of existing stock using a local engineering company, at a substantially lower cost. Such a decision that took local conditions and the availability of local suppliers into account would have been less likely under BAA's centralised approach.

---

[72] Stansted noted completion of new retail stores and improved passenger facilities in the airside terminal. This involved £40 million of investment which had been equally matched by retailers.
[73] Yield per passenger at Stansted had been increasing until 2012 after which there was a marked change in the trend and yield per passenger started to decline. See MAG Annual Report for the year ending March 2015, p23, Figure 3.26 indicating the aeronautical yield per passenger of £7.50 and £7.10 for the years ending March 2014 and 2015 respectively.
[74] See MAG 2015 Annual Report, p14.

Better community relationships

5.34 Stansted told us that its community relationships under BAA ownership appeared to have been fractious. Stansted said that it was making strenuous efforts to change this based on MAG's community and stakeholder engagement experience and progress was being made. Stansted referred to joint community engagement with Ryanair which, like the airport, had ambitious growth plans and so wanted to improve community relations. Stansted also mentioned that a new school educational resource facility costing £500,000 had recently opened in the aero-zone.[75] In Stansted's view this voluntary initiative would not have been entertained by BAA.

Freight/cargo operations

5.35 Stansted noted the development in its freight/cargo hub. This area of the business, which it considered had been side-lined by BAA, was now experiencing strong growth. As an example, Stansted mentioned that FedEx had recently completed an expansion of its freight facility.

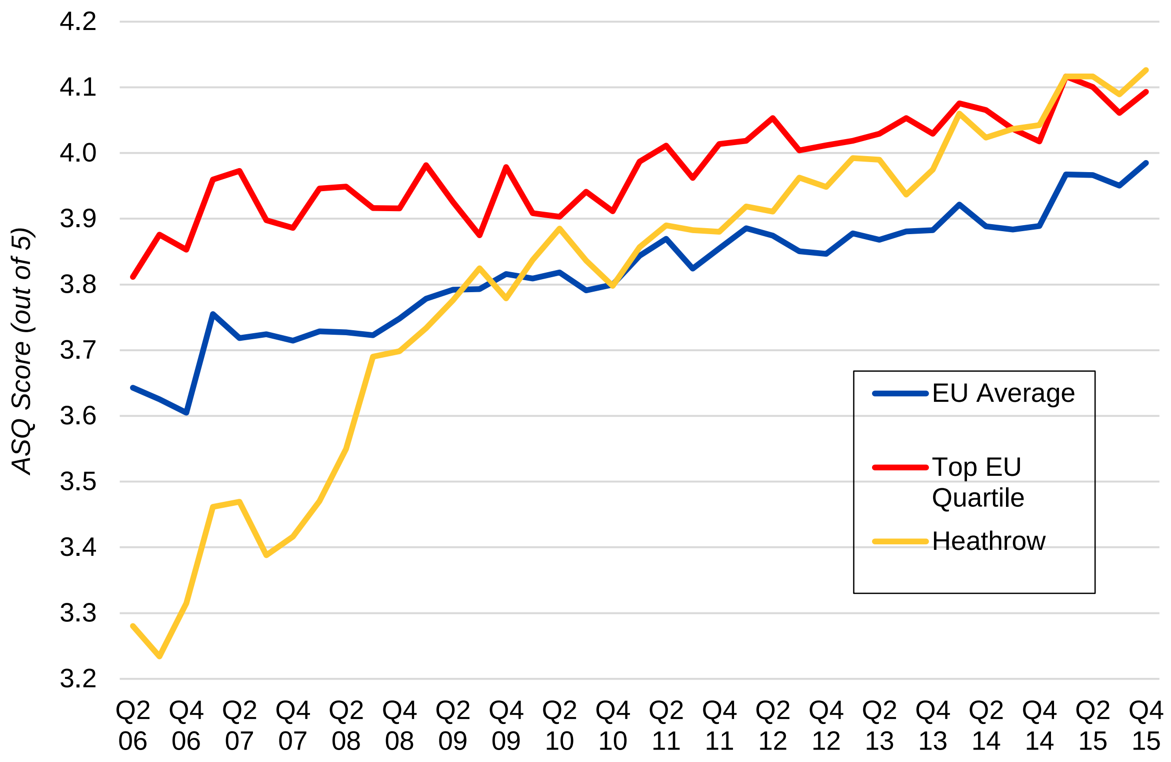
Heathrow

5.36 Since 2008-2010[76] Heathrow has adopted a new management strategy with a greater focus on passenger experience and a 'team Heathrow' approach shared with wider stakeholders.[77] A further change in focus that Heathrow referenced was its objective to give passengers with 'the best airport service in the world'. Previously it had aimed to be the best European hub airport, but had now adopted a more ambitious objective which it considered realistic given the strong improvements in customer satisfaction secured over the last eight years, as indicated by the graph below.[78] As a result of these improvements, in 2015 the airport scored above the average of the top quartile of European comparators for overall passenger satisfaction.

---

[75] The aero-zone is an on-site education centre at Stansted that uses aviation examples to promote the study of subjects including science, technology, engineering and maths.
[76] New management had been appointed in 2008-2010 but had not stabilised until 2011.
[77] Including employees, contractors, retailers, airlines and Border Force.
[78] We note that the sustained improvement in service quality started around the time the CC started to investigate the BAA airports having received the market investigation reference from the OFT in 2007.

Figure 5.4: Heathrow service scores 2006 to 2015 vs its European comparators



Source: Heathrow.

5.37 Heathrow pointed to a number of developments under its new management strategy which are summarised below.

Service quality

5.38 Heathrow told us that it had changed its approach from a focus on capex and regulation to focus on passengers' changing expectations and putting passengers at the heart of Heathrow's decision making process.[79] Heathrow analysis indicated that in 2015 the service standard - for passengers to wait no longer than 5 minutes at security for 95% of the time - had been met every month in every terminal. Heathrow said its focus on passengers and increased service to passengers also had reputational benefits.

5.39 Heathrow mentioned the development of one large Airports Operations Centre (APOC), in place of 27 separate control centres as a major investment that improved the monitoring of service provision and media reactions. APOC encompassed Border Force and the Meteorological Office and was developed by benchmarking an example from Hong Kong airport, but with Heathrow seeking to design this at the next level of sophistication. In order to plan

[79] Heathrow affirmed that its shareholders were committed to major investment to improve the airport.

effectively for security queues APOC monitored traffic flow on the M25 and arrival times of the Heathrow Express train service. Social media comments relating to service quality at the airport were tracked and relayed to operational staff within six minutes.

Efficiency

5.40 Heathrow outlined investment and process changes that had improved operational efficiency. These improvements included:

- shared check-in desks and self-service-kiosk facilities between different airlines in Terminal 2, which had saved space and helped drive efficiency savings for airline customers; and
- automation of baggage handling facilities in Terminal 3 to improve speed and accuracy, together with reducing injuries to baggage handlers.

Structure of charges and route development

5.41 Heathrow told us that the possibility of attracting new airlines was limited by its capacity constraints. However, Heathrow applied an airline charging policy to encourage fuller planes and hence better use of existing capacity. Heathrow also pointed out that it was competing for routes to emerging markets. Heathrow explained that it was competing with Gatwick for airlines and had recently won two long-haul routes (operated by Vietnam Airlines and Garuda Indonesia) previously operating from Gatwick. Vietnam Airlines was now operating daily from Heathrow Terminal 4. Heathrow told us that Vietnam Airlines had switched because it was more profitable for it to operate at Heathrow with strong transfer traffic and premium demand offsetting higher airport charges. Heathrow said that the Vietnam Airlines flights had operated four flights per week out of Gatwick and in the low season the route had required a stop in Frankfurt to increase its passenger numbers. Garuda Indonesia has been operating from Heathrow Terminal 3 since March 2016.

Importance of service quality and benchmarking of service measures

5.42 Evidence summarised so far suggests a great focus on passenger experience and quality improvements (eg in relation to check-in or security services). This is reflected in the level of investment and innovation which appears to have been tailored to airport-specific needs. The importance of service quality measures is further evidenced by a strong degree of benchmarking in ASQ by Gatwick, Stansted and Heathrow.

5.43 Gatwick noted that airports now had a focus on comparative quality. It also noted that relative service provision was now an important factor of competition which influenced passengers' travel choice from or to airports. Gatwick evidenced this from the extensive analysis it undertook of ASQ data that provided customer views on the quality of different aspects of service at different airports.[80] The results of the ASQ survey suggest a marked improvement of service quality at Gatwick: the airport was ranked 12th for overall satisfaction among a panel of 20 of its peer airports at the time of the divestment and during the period 2014 to 2015 its ranking had progressed to between 4th and 8th within the same panel.[81] This improvement is further evidenced by data on Gatwick's performance relative to regulatory targets; namely, the increase in the proportion of service quality indicators passed. For example, for the North Terminal, on average 72% of the service quality indicators (including indicators for cleanliness, flight information and seat availability) were above the target before the break-up (between April 2008 and December 2009) which increased to 91% after the divestment (between January 2010 and September 2015).[82]

5.44 Figure 5.5 shows passenger satisfaction feedback, as represented by ASQ scores, for the two terminals at Gatwick over time. This is a good example of how major investment and process changes can improve the customer experience. Gatwick told us that when it was divested by BAA in late 2009, it inherited a poor South Terminal with problems at security being a particular passenger frustration. In the period shortly after the change in ownership some improvements were made through process changes. Major investment was necessary but could not commence immediately. During the period 2010 to mid-2013, passengers were affected by disruption due to the refurbishment works. The main investment was completed in the second half of 2013 and since then passenger satisfaction in the newly refurbished South Terminal has improved in absolute terms and relative to the North Terminal.

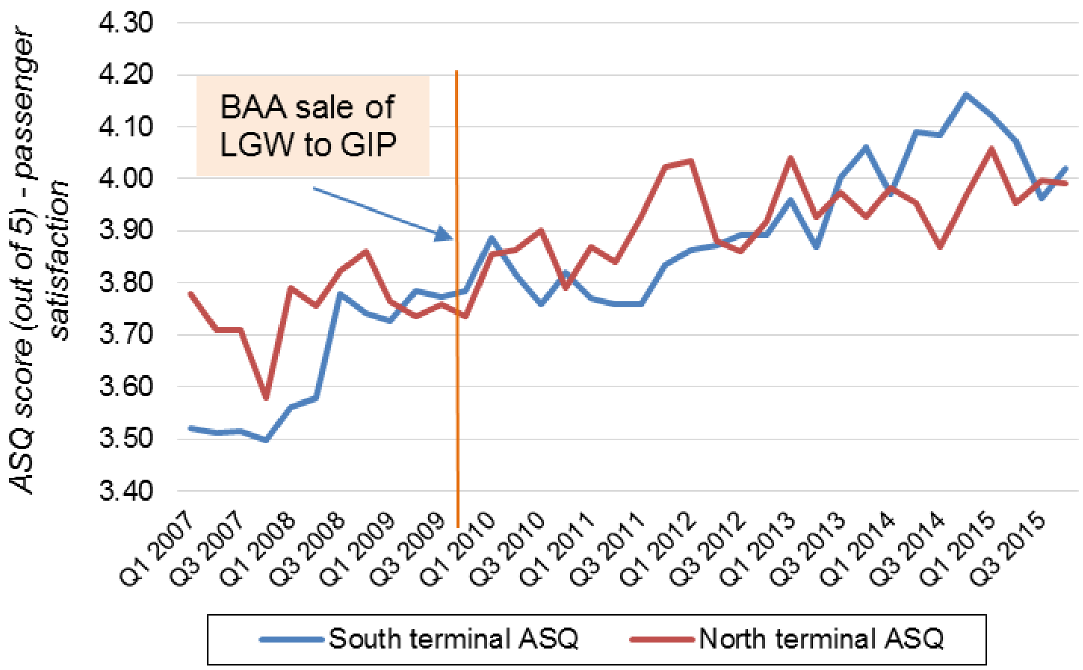
---

[80] Gatwick examined this information in detail regularly to identify the high performing aspects of its service and those with room for improvement, motivated by a desire to outperform its rivals and continuously improve. Gatwick also used this information to identify good practice at competitor airports. Its approach was that it was happy to proactively learn from good customer experiences at and positive initiatives taken forward by rival airports. Gatwick considered that this desire to benchmark and take note of developments at other airports had not been a major focus when it was previously part of the BAA structure. It suggested that BAA had taken an insular approach to services offered.

[81] See Oxera report for Gatwick, p59.

[82] See Oxera report for Gatwick, p58.

Figure 5.5: Gatwick's passenger satisfaction by terminal



Source: CMA analysis of ASQ score by terminal provided by Gatwick.

5.45 Likewise, Stansted under new ownership had taken a similar approach with a focus on quality through reviewing the quarterly ASQ data. In addition, Stansted has extended its quality assessment process to gather information such as net promotor score metrics which assess if customers would recommend Stansted to others based on their experience.[83] MAG, the owner of Stansted, also benchmarked performance within the airports it operated noting the different passenger profiles that use these airports.

5.46 As indicated in paragraph 5.36, Heathrow benchmarks itself against other airports in Europe and worldwide. In addition, Heathrow had also extended its benchmarking into sectors outside the aviation industry such as retailers with a strong customer service proposition. It felt that to excel as an airport it was important to benchmark with others with a strong customer focus and those known for 'service recovery', maintaining strong customer satisfaction when not all went to plan.

[83] In terms of the ASQ data, Stansted's internal target was to be ranked in the lower part of upper quartile performance. Performance data was discussed with airlines, both individually and through the Airport Operators Committee that met monthly, and service quality formed part of the agreements with airlines (eg rebates attached to 'hard' quality measures such as security times).

Views of airlines, government bodies and other stakeholders

5.47 Independent stakeholders also noted the performance turnaround following the divestments. The CAA suggested there had been a major change in the behaviour of Gatwick and Stansted, particularly in terms of responsiveness to passenger and airline needs and aspirations. The DfT and CAA both commented that the airports, including Heathrow, had become more conscious of their branding and presentation, and had developed strong identities. This had potentially led to these airports being more conscious of, and more reactive to, public perception. The DfT mentioned that airlines had been working more closely to influence airport investment decisions. Airports were keen to respond to the airlines so that they could retain and attract passengers. However, the DfT also added that it may be too early to substantiate this point.

5.48 The CAA outlined its view that its decisions to deregulate Stansted and use a lighter form of regulation at Gatwick had facilitated commercial arrangements with airlines encouraging growth in traffic. This in turn, along with the general improvement in overall economic conditions, had contributed to improved customer choice by making a greater number of routes and frequencies available to passengers. However, the CAA also commented that it was more likely that passengers would receive the benefit of lower airport charges if there was stronger competition among airlines operating at each airport. It emphasised the importance of this, particularly in the presence of airport capacity constraints, in allowing a greater share of this benefit to be passed on to consumers.[84]

5.49 ACI Europe reported that there had been increased rivalry between airports in the South-East and that this increased rivalry was strongly influenced by the remedies. ACI Europe mentioned the following factors as evidence of increased competition as a result of ownership separation:

- Airports offering dynamic route development marketing, especially Gatwick and Stansted.
- An increase in investment at the airports, initially at Heathrow and Gatwick but more recently also seen at Stansted.
- Improvements in the ASQ (customer satisfaction) scores at the London-served airports.

[84] It also noted that rivalry had led to a more efficient use of existing airport capacity by incentivising airlines to use larger aircraft.

- The offering of more discounts to airlines, with the airports being more dynamic in their approaches to meet the needs of the airlines.
- Changes in the branding and presentation of the London airports.
- The competition between Heathrow and Gatwick for new runway capacity.

5.50 According to IATA, the remedies have addressed some of the negative effects arising from common ownership of Gatwick and Heathrow, but significant market power of airports still remains. This is because of (i) capacity constraints; (ii) locational preferences; (iii) market dynamics and client supplier relationship, including airline switching cost; and (iv) differences in economies of scale across other airports.

5.51 A number of airlines we and/or ICF spoke to as part of this evaluation highlighted the benefits stemming from bespoke commercial contracts and a greater focus by airports on service quality and on providing passengers with a good customer experience. A few airlines felt the developments were not as significant as they could have been due to capacity constraints, difficulty in airline switching and market power of the airports. Benefits were mainly mentioned in relation to the passenger market whereas the freight market appears to have been less affected by the remedies according to a major cargo operator.

(a) Ryanair told us that any potential increase in competition as a result of the break-up of the BAA monopoly, had been dampened by the capacity constraints at the London airports. Ryanair considered that competition was hindered by the capacity constraints in the London and South-East market.

Ryanair said that it had observed changes in the approach of airports after their divestment. It provided the example of Gatwick that had amended its charging scheme to incentivise larger aircraft with higher load factors under its new ownership structure to maximise usage of its capacity. As a result of the changes in its charging scheme, Gatwick now had larger, fuller planes operating and the operational efficiency of the runway was noted as superior relative to some other airports with one runway.

Ryanair told us that a ten-year commercial contract had been secured with Stansted and that such a deal would likely not have been possible had the airport still been owned by BAA.[85] [✂] Ryanair stated that UK consumers would benefit from these commercial agreements with Ryanair as it was now able to offer passengers a greater number of routes and flights from Stansted given the certainty arising from a long-term deal.

(b) According to easyJet there is now competition between Stansted and Luton and Stansted is generally reactive to competitive pressure from Luton. easyJet also told us that Stansted was more amenable to negotiation than it used to be although it would be difficult to know whether BAA could have eventually cut prices had it still owned Stansted. easyJet also pointed out that there had been improvements at Gatwick. As a result of this, Gatwick was now a better-run airport and users, including passengers, had benefited from improved operational outcomes at airports and some service quality improvements. However, easyJet also noted that there had been more recent issues around Gatwick's resilience. easyJet considered that some of the observed changes could have occurred without the CC's remedies but improvements had been sharpened by rivalry between airports.

(c) Monarch noted that airports in the South-East had become more commercial since the divestiture of Gatwick and Stansted with the greatest impact being competition between Heathrow and Gatwick. Monarch noted that increased competition had meant that airports were more focused on their ability to move passengers as quickly, securely and safely as possible. Improved customers focus and experience had been facilitated by the CC remedies though the remedies were not exclusively responsible for these changes.

(d) IAG:

(i) Aer Lingus noted that divestment had a positive impact at Stansted resulting in a greater commercial approach. Aer Lingus considered that this was demonstrated by the new commercial agreements struck with easyJet and Ryanair. However, at Heathrow and Gatwick Aer Lingus noted significant constraints on slots meaning barriers to switching remained. It also noted there had been no change in negotiating power between airports and airlines.

(ii) BA noted that competition could only develop in circumstances where there was both separate ownership of airports and spare capacity,

---

[85] Ryanair told us that airport service quality had improved as a result of the divestments, though it noted caution with service improvements if they were characterised by higher capital investment that led to higher than otherwise airport charges.

and hence airlines were able to exert market disciplines on airports through marginal switching. BA noted there was a difference between the approaches taken by the ex-BAA airports.

BA considered that competition had not developed at Gatwick and Heathrow as result of an absence of spare capacity which it stated meant airlines had broadly been unable to exert market disciplines through marginal switching between the two.

BA considered Stansted was competing to an extent, by offering volume-related deals to incumbents and new entrants. BA said this was relevant to point-to-point airlines, which were able to engage in marginal switching. Network airlines, on the other hand, would have to bear significant commercial and operational costs, were they to establish an operation that was significant enough to be attractive to passengers. BA considered that these costs affected the incentives of network airlines to switch away from existing hub airports.

BA also noted that under BAA ownership Stansted had not offered discounts because this would have attracted marginal traffic from Heathrow and Gatwick therefore cannibalising BAA’s most lucrative operations. Under separate ownership, with a relatively low cost base and with more spare capacity than either Heathrow or Gatwick, BA considered Stansted was keen to encourage growth. On the other hand, as noted above, BA also told us that capacity constraints at Gatwick and Heathrow limited the development of effective competition at these two airports as airlines could only exert market discipline through marginal switching if sufficient spare capacity existed.

(e) Virgin Atlantic told us that whilst it supported the principle of more competition and hence supported the divestment of ownership by BAA, it had not seen material changes arising from its use of Heathrow and Gatwick due to the individual market powers of these airports. It was also noted that it was difficult to switch routes between Gatwick and Heathrow for reasons that include slot availability. Furthermore, Heathrow had continued to charge at the maximum of its regulatory price cap so it was difficult to evidence a benefit from separate ownership in terms of airline charges, unless the CAA had factored this into its price determination.

At Gatwick, Virgin Atlantic commented that the charges were more flexible with Gatwick’s contracts and commitments approach but Virgin Atlantic considered that this was not necessarily due to the new ownership structure. Virgin Atlantic said it was difficult to identify if it paid lower airport charges under the contracts and commitments framework than if a regulated single price cap charge had still existed. Whilst the opportunity to negotiate with Gatwick was welcomed by the airline, there was an inability to negotiate with an entity with significant market power, and it was difficult to establish the financial success of such negotiations.

In terms of a revised approach of airports more broadly, Virgin Atlantic cited the example of Gatwick which was increasingly considering operational performance solutions as an alternative to BAA's traditional capex-led projects. Virgin Atlantic considered that Gatwick's motivation for these operational performance improvements was based on the desire to control costs efficiently and to generate new capacity opportunities for revenue growth.

(f) One of the major cargo operators that ICF spoke to noted that competition between airports was much more relevant for passenger operations than for freight operations and that switching was more difficult for freight operators because of the necessary investments and sunk costs. This operator considered that the CC's remedies had had little effect on the freight market in the UK. This stakeholder also noted that maintaining a good relationship with the owners of the airport(s) was important. This was a two-way effort and the cargo operator noted an increased flexibility and openness of the management team at the airport from which it operated.

Other airports

5.52 With regards to airports not directly involved in the divestment, Luton Airport noted that there had always been a high level of competition between airports. Birmingham airport, which is discussed in greater detail in paragraph 5.61, noted the increase in competition between airports in the South-East.

Summary of changes at airports under separate ownership

5.53 The evidence we have gathered from stakeholders shows positive changes at all three ex-BAA airports in the South-East since the CC's remedies were implemented.

5.54 Of the divested airports, improvements are most evident at the largest divested airport, Gatwick, which was the first to be sold and has benefited from the longest period for the development and implementation of its new commercial strategy. Under separate ownership Gatwick has been actively competing to attract and retain airlines and routes and to become a more attractive airport for passengers. Improvements at Gatwick are reflected in better relationships and operational arrangements with airlines, increased efficiency, capacity generation, innovation and better service quality. Increased competition and better performance of Gatwick have also allowed the use of more flexible regulation.

5.55 Stansted was the last of three divestments associated with the CC remedy, changing ownership in 2013. Already there are signs of considerable progress at Stansted. Service quality based on passenger satisfaction metrics has been impacted by major reconfiguration investment to improve the terminal space including retail and security areas. However, there is recent evidence of service quality improvement as these works reach completion. The airport has better commercial arrangements with airlines compared with those under BAA ownership and this has contributed to the decision that Stansted no longer needs to be subject to price control regulation. This is a significant change and has occurred promptly in response to the new competitive landscape in the South-East.

5.56 Service quality at Heathrow has improved steadily and Heathrow has also undertaken investment and process changes that have improved its operational efficiency. Heathrow's new commercial strategy has also led to route development within the limitations of capacity constraints. We consider that improvements have been facilitated by increased management focus operating Heathrow as a stand-alone airport after the divestments and are consistent with increased competition between airports in the South-East as well as increased competitive pressure from other international hubs.

The effect of capacity constraints on the potential for competition

5.57 In stating that competition had increased between airports in the South-East following the divestments, a significant number of stakeholders referred to capacity constraints at Gatwick and Heathrow as well as at Stansted at peak periods. In particular, Gatwick and Heathrow are operating close to full capacity as the availability of spare runway slots is low or non-existent. These stakeholders said that this limited the development of competition in the South-East. Stakeholders considered that there were benefits from the additional competitive forces now in place following the separation of ownership, but these would be greater if there was more airport runway capacity available in the South-East. This is consistent with the CC's view at the time of the market investigation; namely, that the benefits arising from the divestments in the South-East would evolve as capacity constraints were alleviated.

5.58 While it is clear that competition between airports in the South-East market can occur despite capacity constraints, the fact that capacity constraints have an impact on the potential benefits of the CC's remedies is important context for our evaluation.

5.59 It is reasonable to draw the conclusion that if capacity constraints in the South-East were relieved, the effect of the CC's remedies would be significantly enhanced. In the presence of capacity constraints, airports are limited in their ability to increase volumes by reducing airport charges and hence have little incentive to offer discounts to airlines. In contrast, with spare capacity, airports would be even more proactive in approaching airlines and offering discounts to attract them to fill capacity. From the airlines' perspective, the main disciplining force they can use to incentivise airports to reduce charges and increase service quality is the threat of switching some of their routes or their entire operations to alternative airports. However, this is only a plausible and credible strategy if there is spare capacity at those other airports. Therefore, we consider that additional capacity in the South-East would strengthen the process of rivalry between airports to win and retain airlines and would also increase competition between airlines. This would benefit airport users through the following:

(a) Lower air fares as additional capacity would make it easier for airlines to expand their operations at airports. This would put downward pressure on airlines' fares through increased competition.

(b) Further improvements in service quality as a result of airports competing more intensely for airlines and passengers.

(c) Potentially lower airport charges, although this would also be affected by the cost of expansion, the expanding airport's approach to recovering investment costs and competitive responses by other airports.

(d) Greater choice in the form of further route development. Airlines told us that capacity constraints limited their ability to switch operations between airports. Capacity constraints also prevent new airlines commencing services from airports. For example, Heathrow told us that around 80 airlines operated there now and over 30 additional airlines would like to operate from Heathrow but were unable to do so due to capacity constraints. Gatwick has around 50 current airlines and around 16 airlines wishing to use Gatwick but unable to do so due to capacity limitations.[86]

5.60 While we recognise the importance of additional capacity for competition to deliver customer benefits, exploring how extra capacity should be delivered,

[86] Stakeholders did not provide the names of these airlines and hence it is not possible to assess the overlap between airlines that want to use Gatwick and those that want to operate from Heathrow.

including where this extra capacity should be built, was not in the scope of our evaluation. This is a matter for ministers to determine.

Benefits beyond CC expectations

5.61 The evidence presented above confirms the CC's expectations about the likely benefits of the remedies (see Section 3 and Appendix 2 for further detail of the CC's expectations). However, stakeholders mentioned examples that suggested that the divestments had resulted in benefits over and above those anticipated by the CC. Three particular examples of additional benefits have been identified:

(a) **Increased competition at Birmingham Airport**. Although it was not directly affected by the CC's decision, Birmingham Airport told us that increased competition in the South-East, which had been driven by a number of factors including divestiture,[87] had led to significant growth and improvement at this airport. Whilst some modest impact was envisaged by the CC, the competition effects at non-divested airports were probably underestimated in the 2009 investigation.[88]

(b) **Additional airline competition**, arising from airports' increased engagement and responsiveness to airlines. A number of stakeholders reflected that airline competition would have been lower if BAA had still owned the three largest airports in the South-East and allocated airlines among these airports. Airlines are competing to gain slots at the divested airports and whilst this is not new, it appears to have intensified as a result of the divestments. Gatwick told us that it now published inbound baggage performance metrics for some of its airline customers, which encouraged airlines to compete to provide a better service.

(c) **More active local community engagement**. Stakeholders noted that airports had made progress in their community engagement, for example via new online complaint portals and by seeking more perspectives from local residents and community groups.

---

[87] Other factors that have influenced growth and passenger numbers at Birmingham Airport include the Open Skies agreement, the UK economy emerging from recession, the reduction of fuel prices and Heathrow capacity constraints leading to more passengers flying at other airports.
[88] It was also suggested that a third runway at Heathrow would have negative effects on growth and competition in the UK market. Birmingham Airport has grown in recent years, particularly in long haul, and this has partly been a result of constraint at Heathrow encouraging airlines to test and grow new markets. As a consequence, choice for passengers and competition between Heathrow and Birmingham Airport has increased. Birmingham suggested that expanding Heathrow would reverse this situation, allowing airlines to secure further slots at Heathrow and discouraging them from trying new markets and offering new routes to customers.

Unintended consequences

5.62 We asked stakeholders if they were aware of any unintended consequences arising from the divestments of Gatwick and Stansted in the South-East. No significant examples were provided associated with the remedies.

5.63 Heathrow said it was possible that BAA's sale of other smaller regional airports in the group, those outside the remedies process,[89] may have occurred earlier than would have been the case. This was because after the sale of Gatwick, Stansted and Edinburgh, which were in the middle of the size spectrum of the seven airports in common ownership, BAA's head office functions were no longer viable with the new structure. Heathrow suggested that this may have led to synergies from common ownership being lost earlier and hence the regional airports incurring cost increases as a result of the loss of scale economies and lower purchasing power. However, Heathrow also acknowledged that its board had recognised that operating Heathrow as a stand-alone airport gave rise to benefits given the scale and complexity of the airport. We note that other airports and other stakeholders have not indicated that economies of scale arising from common ownership of multiple airports are appreciable. On this basis we consider that even if economies of scale from common ownership were lost, it is unlikely that the benefits of increased competition have been undermined.

Importance of enabling factors

5.64 During our interviews with stakeholders, a number of points were made about the interactions of government agencies/departments with airports and the role these organisations play in the provision of services to airports. In particular, some stakeholders considered that the DfT, Network Rail and Border Force had been slow in responding to the new competitive landscape. Some stakeholders were of the view that there is some inherent positive bias from agencies towards Heathrow and to a lesser extent towards Gatwick, and suggested that the other airports subsequently receive less focus, investment and resourcing. These agencies told us they were confident that there was no such bias. Network Rail also told us that the promotion of investment was affected by a number of factors, including the level of current and predicted future demand and levels of crowding. Border Force mentioned that they had been protecting and, in some cases, reinforcing staffing levels at airports that had witnessed significant passenger growth in the past years. Border Force also pointed out that decisions about staff deployment were driven by a range of considerations, including security ones, that were not always immediately

[89] The CC remedies required BAA to sell Gatwick, Stansted and either Glasgow or Edinburgh.

obvious to commercial operators. Notwithstanding these differing views, the question remains whether remedies arising from market investigations should explicitly consider the wider enabling factors that may also need to change so that competition can develop to the greatest possible extent.

Overview of evidence relating to changes in economic regulation

5.65 The DfT told us that the CC's recommendations for changes to economic regulation were seen as important, credible suggestions that ministers were keen to see implemented swiftly. Outside government, the recommended changes were also positively received by most stakeholders. This led to swift development of the necessary legislative changes and the introduction of CAA12. Estimates made by the DfT highlighted a total benefit of £195 million over a 20-year time horizon from reforms to the economic regulation of airports.

5.66 The general consensus from the stakeholders we have spoken to was that the previous economic regulation in the airports sector was out of date compared with approaches in other regulated sectors and good regulatory practice. In light of this the recommendations of the CC were not seen as controversial, being largely based on bringing the sector into line with better regulation principles developed elsewhere.

5.67 The CAA told us that the CC's recommendations led to legislative changes that made its primary duty a focus on passengers and those with an interest in cargo, and to promote competition where appropriate.[90] This was an important development and has been universally welcomed. One of the outcomes of this is that airports and airlines are now working collaboratively to improve service to passengers. This heightened engagement is seen as positive for both parties and for passengers, as is the CAA's duty to promote competition.

5.68 Another significant change was the removal of the mandatory reference to the CC for advice on the CAA's price determinations. This had always been considered an odd dynamic and its cessation has increased the incentives on the parties involved to make sure the price review produces a credible outcome, without needing the CC's assistance. Parties can now choose to appeal, but a reference is no longer mandatory. It is likely there has been a saving to parties and regulators from the removal of mandatory review; especially given that there have been no appeals to the CMA over price determinations under CAA12.

---

[90] CAA12, Section 1 (1) and (2).

5.69 In terms of appeals, one airport suggested that it was perhaps too easy for a stakeholder to request an appeal, and that the list of stakeholders that could request an appeal was too wide. This airport would have preferred appeals to be restricted to the affected parties and a designated customer group. The airport suggested that an appeal was relatively easy to lodge, whereas the workload and delayed outcome for an appeal would rest with the regulator and specific airport affected. Others, such as the DfT, CAA and airlines suggested that an appeal required extensive resources to be allocated and noted that, to date, no airline or consumer body had appealed.

5.70 The increased flexibility of the regulatory regime is welcomed by all stakeholders who commented on this subject. Flexibility arises from a number of features of the new regulatory landscape, eg the adoption of the licensing regime that can place specific requirements on individual airports; the length of price control periods; and ultimately from the ability of the CAA to undertake MPDs to assess which airports need to be regulated. Those airports subject to regulation have themselves started to focus more on service and on meeting passengers' expectations. They are less focused on the regulator and focus more on delivering well run operations. The tendency to favour capex solutions also appears to have diminished, with instead more focus on process improvements as an alternative.

5.71 The flexibility of regulation has produced a new dynamic. Those airports that are regulated are seeking to strengthen the extent to which competitive market forces are in place to negotiate commercial arrangements. With such an approach there is a greater chance of lighter touch or even no regulation applied to the airport. Gatwick has developed a contracts and commitments framework with airlines and this contributed to the decision of the CAA to extend the current price control period from five to seven years.[91] Similarly, Stansted's commercial contracts with airlines such as Ryanair and easyJet was a factor in the deregulation of this airport, meaning it is no longer subject to regulatory price controls. easyJet told us that it was supportive of the lighter touch regulation at Gatwick as set out in the current regime. However, easyJet remains of the view that Gatwick has significant market power. Heathrow told us that it was also looking to negotiate commercial terms with its airlines. ACI Europe told us that it was a strong advocate of the proportionate economic regulation framework as now applied by the CAA. ACI Europe often used the example of the UK approach as an example of good practice for wider regulatory changes at an EU level.

[91] The CAA issued Gatwick with a licence for seven years from April 2014.

5.72 In a similar vein, those airports not subject to regulation are incentivised to act in the interests of passengers and deliver a high quality, efficient service. They certainly need to avoid any perception of abuse of local market power and there are incentives on performance and behaviour to avoid the likelihood of an MPD being requested and undertaken.

5.73 The CC did not consider that the level of competition following divestments would necessarily be sufficient to remove the need for price caps at Stansted and Gatwick before new runway capacity became available.[92] The revised focus and strategy of airports, as discussed earlier, have in part enabled the CAA to deregulate Stansted and adopt a lighter touch regulatory approach at Gatwick[93] despite no new runway having been approved in the South-East since the CC's decision.

Unintended consequences of economic regulation changes

5.74 The CAA suggested there were potentially some unintended consequences from the changes made to economic regulation. First, public interest tests were no longer undertaken if there were concerns at specific airports. It did however state it could use the licensing regime now in place to address any major issues. Second, the CAA said its new secondary duty to ensure that the licensed airports were sufficiently financed could potentially transfer some risk from the airport operator to airport users. Overview of qualitative evidence relating to competition for new runway capacity in the South-East

5.75 The CC considered that the process of multiple bids from airports under separate ownership would facilitate government decision making in determining which runway development proposal to support. Independent projects in terms of costs, efficiency, deliverability and environmental effects could be considered rather than reliance on BAA (one organisation's) assessment.

Context of evaluation

5.76 The purpose of our evaluation is to assess the impact of the CC's remedies. This includes assessing the impact of the CC's recommendation to government on planning policy. We include assessing whether the divestment of Gatwick and Stansted has led to a different approach by airports competing for additional capacity versus the counterfactual of common ownership and

[92] 2009 report, paragraph 10.344.
[93] Gatwick operates a contracts and commitments framework rather than being subject to formal price cap regulation.

the previous government approach to planning. We do not include assessing the merits of analysis and recommendations by third parties and any resultant government decision. This principle applies both to the recommendation of the Airports Commission, but also to the economic regulation decisions taken by the CAA since the CC's recommendations were made.

5.77 Within the context of this evaluation, we did not consider it appropriate to conduct our own assessment of the potential future impact on airport competition of the different options for increasing runway capacity in the South-East. During our stakeholder interviews, some comments were made in this area. We explained this was not within the project scope and our published terms of reference of this evaluation.

5.78 Decisions regarding this important issue are properly the role of ministers, drawing on the evidence and recommendations of the independent review that the Airports Commission has conducted. We recognise that the Airports Commission considered, among other factors, the potential implications for competition of the different proposed expansion schemes.

5.79 The government is now considering the recommendation of the Airports Commission and is expected to make a decision later this year. We have no reason to believe that ministers, when making their decision, will not take the impacts on competition into account, alongside other relevant factors, when considering the Airports Commission recommendation.

Views on revised process

5.80 The CC considered that BAA's common ownership of the three major airports in the London area appeared to have exacerbated delays in the delivery of runway capacity and noted BAA's reluctance to press for more runway capacity.

5.81 All of the stakeholders we spoke to were of the view that the process by which airports have competed for new runway capacity has been different from that which would have prevailed absent the remedies. Stakeholders considered that there would have been only one proposal for additional runway capacity in the South-East if BAA's common ownership had continued. In contrast, following the CC's intervention, competing proposals emerged. Stakeholders told us that this:

- *(a)* had allowed consideration of the merits of different scheme design proposals to be compared - proposals had more scrutiny and could be benchmarked;
- *(b)* had incentivised airports putting forward bids to make improvements;

(c) was highly likely to have led to lower costs of expansion plans; and

(d) had encouraged greater consideration of options to reduce the environmental impact of expansion.[94]

5.82 The fact that Heathrow faces competition from Gatwick and there were other proposed schemes in the early Airports Commission process for this extra runway capacity is also evidence that the investor community remained supportive of the airports sector. This is contrary to suggestions that the CC's strong interventions had possibly discouraged investors.

Potential unintended consequences

5.83 Whilst most stakeholders were positive about the competition that had prevailed to secure approval for a new runway in the South-East, some stakeholders gave mixed views and noted two potential unintended consequences:

(a) Delays to reaching decisions on the location for new capacity.

(b) Excessive marketing, public relations and preliminary costs incurred by the parties competing for the runway.[95]

5.84 We note that in this evaluation it would have been difficult to quantify costs relating to making runway bids and forming a judgement as to whether these were excessive. It is also possible that the two factors are linked in that delays in making a decision have led to higher costs. However, no stakeholders provided information about costs or analysis demonstrating that costs were likely to outweigh expected benefits or evidence of excessive delays caused by the CC's remedies. Enhanced local community and stakeholder engagement by the airports bidding for new runways is in our view an improvement on the likely counterfactual position.

Main findings of ICF's analysis

5.85 ICF used a range of evidence, including stakeholder interviews and numerous data sources, to analyse the impact of the CC's remedies. The details of ICF's qualitative and quantitative assessment are in ICF's report which is published alongside our document.[96] In paragraph 5.51 we make reference to some of

---

[94] We note that BAA may have considered various options that could have at least achieved some of the aspects considered here.
[95] One airline told us that Heathrow and Gatwick had incurred preliminary expenditure in advance (and in spite of government's postponement) of a decision as to the location of a new runway.
[96] CMA case page.

the qualitative evidence gathered by ICF whereas in the following paragraphs we summarise the main findings of ICF's data analysis in relation to: passenger numbers and air transport movements (ATMs); route development; service quality; airport charges; and airports' efficiency.

Passenger numbers and ATMs

5.86 Data gathered and analysed by ICF shows that passenger numbers have increased at Gatwick and Stansted since their divestment. This is illustrated by Figures 3.2 and 3.3 in ICF's report and by Figures 4.2 and 4.4 in our report. As demonstrated by Figure 4.8 of ICF's report, the number of passengers travelling through Heathrow has also shown a clear upward trend since 2010 despite its capacity constraints. The data also shows that the share of London passengers travelling to/from Gatwick and Stansted have increased since divestments despite runway capacity constraints at peak times.

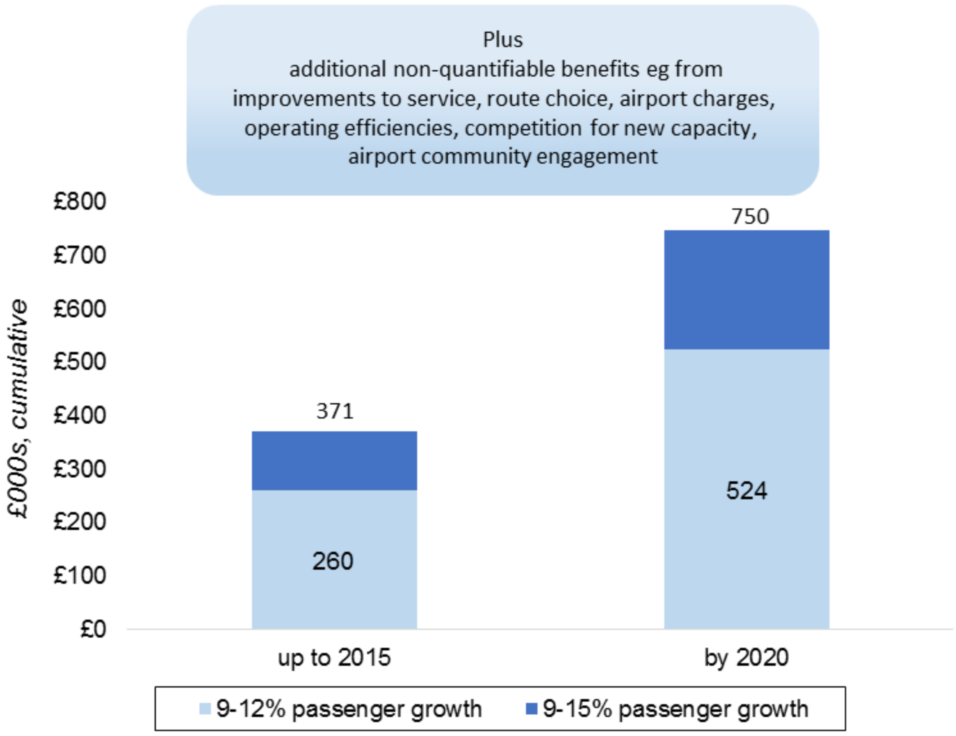
5.87 Changes in passenger numbers could have been affected by a number of factors other than the CC's remedies, including macroeconomic conditions. In order to identify possible observable impacts of the divestment of airports in the South-East (and that of Edinburgh), ICF also undertook econometric analysis. They analysed airports' capacity utilisation, measured as the number of ATMs and total number of passengers, to compare passenger throughput before and after the divestments at the divested airports compared with a control group of non-affected airports. In particular, ICF employed panel regression, using a panel of 24 UK airports to test whether positive changes in overall ATMs and passenger numbers at the divested airports were above that which would have been expected in the counterfactual scenario.

5.88 Using different model specifications (eg regarding the timing of impact or the composition of the control group), the results of this analysis suggest that increases in ATMs and passenger numbers at divested airports have been significantly larger when compared with other UK airports.

5.89 The analysis showed that ATMs of the three divested airports were on average 9% higher than the ATMs of the control group, while passenger numbers were on average 9 to 12% higher compared with the control group, after accounting for long-term trends and airport-specific characteristics. Using existing OECD estimates of passenger benefits from changes in airport capacity and airline services related to increased choice and better connectivity, ICF estimated that this change in passenger number translates into £260 million of consumer benefits for the period 2009 to 2015 at Gatwick and Stansted, with further benefits expected in the future.[97]

5.90 With another model specification, in which Heathrow and Glasgow were omitted from the control group, ICF's analysis found that passenger numbers at divested airports were as much as 15% higher on average in the period following separate ownership when compared with the control group. If these partial benefits continue to accrue at the annual level quantified for 2015, using the model specification in which Heathrow and Glasgow are excluded from the control group, estimated cumulative nominal benefits for the period 2009 to 2020 would total £750 million at Gatwick and Stansted as shown in Figure 5.6.

Figure 5.6: Estimated consumer benefits from estimated passenger throughput at Gatwick and Stansted



Source: CMA summary of ICF's analysis.

Route development

5.91 Qualitative evidence suggests that the CC's remedies have led to airports in the South-East engaging in greater competitive efforts to attract new airlines

[97] Improvements in connectivity and choice mean that more passengers are able to fly, including some that would not otherwise have done so. These passengers benefit directly from having taken those journeys. Second, expanding supply puts downward pressure on prices for air travel all else being equal.

and routes.[98] The econometric analysis did not show that the divestments coincided with a statistically significant change in the number of routes; however, this could be due to constraints of data availability for this indicator.

Service quality

5.92 The CC envisaged that rivalry between airports in the South-East after divestments would result in increased service quality over time. In order to test this hypothesis, ICF looked at the evolution of service quality measures, such as passenger satisfaction based on ACI's passenger survey and service quality rebates data, at the divested airports. ICF also planned to carry out econometric analysis of service data to explore whether there was any statistically significant change in passenger perceptions around the time of divestments of BAA's airports. However insufficient ASQ data were available to ICF[99] to carry out this analysis.

5.93 ACI's survey data shows that passenger satisfaction at Gatwick has increased markedly since the divestment (see Figure 3.18 of ICF's report). This increase was consistent across a range of passenger satisfaction indicators, including passenger experience at check-in and security, terminal navigation, airport staff and facilities and retail experience. Heathrow has also increased its service quality scores considerably as illustrated by Figure 5.4 of our report.

5.94 On the other hand, passenger satisfaction at Stansted decreased between the date of the divestment and the end of 2014. Stansted pointed out that this decline coincided with major investment and reconfiguration of its terminal which necessitated construction in a live operating environment, temporarily limiting space and causing disruption for passengers during this time. Such disruptions are likely to affect airports with only one terminal (such as Stansted) more noticeably than those with multiple terminals (eg Gatwick and Heathrow). In quarter 4 of 2015, Stansted's passenger satisfaction started to rise.

5.95 ICF also analysed service quality rebates data at Gatwick.[100] This analysis shows a mixed picture: at Gatwick's North Terminal, performance with respect to wayfinding, lounge seat availability, and flight information has fluctuated over the period since the divestment, although ratings of flight information have improved from mid-2013 onward. At Gatwick's South Terminal, wayfinding and overall cleanliness have increased since divestment in 2009.

---

[98] See Section 3.2 of ICF's report and paragraphs 5.17, 5.32 and 5.41 of our report.
[99] ASQ data are not published by ACI and while some airports publish aspects of their individual performance, this information is limited.
[100] Only limited data for Stansted was available and hence this data was not analysed.

More recently, lounge seat availability and flight information have also improved considerably. These trends are also visible on Figures 3.22 and 3.23 of ICF's report.

Airport charges

5.96 Using data between 2000 and 2013, ICF examined total aeronautical revenue and aeronautical yields per passengers to assess the impact of the remedies on airport charges. ICF observed a slowing growth in aeronautical yield per passenger at Stansted. However, the difficulty of controlling for the factors that affect airport charges at individual airports,[101] combined with the constraints on data availability, made it unfeasible to undertake a comparison via regression to assess the impact of the remedies on airport charges.

Airports' efficiency

5.97 ICF looked at operational expenditure and capex at airports to analyse efficiency and also carried out econometric analysis of two indicators: passenger numbers per ATM and the ratio of passengers to staff.

5.98 As discussed in Section 3.6 of ICF's report, data revealed some evidence that divestment at Gatwick has led to lower operational costs across a range of indicators which was also supported by qualitative evidence. At the same time, econometric analysis did not show statistically significant results for changes in efficiency. However, this was likely to be affected by data availability.

Conclusion on ICF's findings

5.99 ICF sought to estimate changes that could be attributed to the CC's remedies in the South-East. ICF's analysis revealed that, for most indicators, current data are not sufficient to support the findings from the qualitative evidence which suggest significant improvements at Gatwick, Stansted and Heathrow in terms of route development, service quality and efficiency. Nonetheless, ICF's analysis provides econometric evidence of a significant increase in passenger numbers and ATMs at divested airports in the South-East following divestment compared with a control group, taking into account long-term trends and airport specific characteristics. ICF estimated that the identified 9

[101] We note that average charges of airports which get a high proportion of their passenger numbers from a few airlines are highly sensitive to the relationship with these airlines and the outcome of the negotiations with them. For example, over 70% of Stansted passengers fly Ryanair and hence changes in Stansted's average charges are strongly affected by the charge negotiated by Ryanair. We also note that airport charges at some airports are subject to price controls.

to 12% passenger number increase could be associated with £260 million of passenger benefits between 2009 and 2015 in the South-East. If these partial benefits continue to accrue at the level quantified for 2015, using the model specification in which Heathrow and Glasgow are excluded from the control group and the passenger number increase is as large as 15%, estimated cumulative nominal benefits for the period 2009 to 2020 would total around £750 million in the South-East.

Summary of findings in relation to the South-East

5.100 From the evidence gathered, including views of the majority of stakeholders interviewed and the quantitative analysis, we conclude that there has been a significant change in the competitive landscape in the airport market in the South-East since the implementation of the CC's remedies. This has delivered sizeable benefits, some of which were over and above those envisaged by the CC. The improvements result from a combination of new and more competitive commercial strategies of airports under separate ownership and the more flexible regulatory framework now in place. As well as increased focus on passenger experience, airports' revised strategies seek to build more productive relationships with airline customers in order to deliver benefits to passengers across key strategic and operational areas. A number of the main factors indicating increased competition and benefits to passengers can be summarised as follows:

(a) **Passenger growth**: Divested airports have achieved passenger numbers at measurably higher levels post-divestment than other UK airports. ICF's analysis suggests that this increase could be as large as 9 to 12% or 9 to 15% depending on the model specification. The higher passenger numbers at Gatwick and Stansted indicated by ICF's analysis are measured after taking account of long-term trends which would otherwise explain changes in passenger numbers at airports, and factors related to the individual characteristics of airports analysed. Gatwick has increased its share of passengers travelling to and from London airports since divestment despite its capacity constraints, as has Stansted. The increase in passenger numbers is likely to have created benefits to consumers in the form of improved connectivity and choice. As a result of these improvements more passengers are able to fly, including some that would not otherwise have done so. These passengers benefit directly from having taken those journeys. Second, expanding supply puts downward pressure on prices for air travel (all else being equal). While wider development in the airports and airlines market make it difficult to establish a definite causal link between the CC's divestment remedies and the increase in passenger throughput, the weight and breadth of

evidence clearly suggests that the CC's intervention was the main driver of the observed changes.

(b) **Efficiency**: Divested airports have increased the efficiency of capital investment in facilities/services and improved their operational efficiency over time. Divestiture has enabled airports to make decisions locally and implement bespoke changes that are optimal for individual airports, switching service providers if necessary. There is greater focus on process improvements than historically, and strong evidence of lower operational costs across a range of indicators at Gatwick. As a result of divestiture and the new regulatory framework in place, the incentive to undertake large-scale capex solutions without clear benefits to airport uses appears to have diminished.

(c) **Service**: Service quality to passengers and airlines has improved markedly at Gatwick, the first airport that was sold. At the airports more recently under new ownership, improvements are expected at Stansted as investment in new terminal facilities and operational initiatives fully embed. Service quality at Heathrow, which also adopted new commercial strategies after divesting the airports required by the CC's remedies, has reached a historic high. In 2015 passengers scored Heathrow's overall service quality above the average of the highest scoring European airports. This is a marked improvement from service scores achieved by Heathrow in 2008 when the airport ranked 97^{th} out of 127 airports surveyed.

(d) **Route choice**: Efforts to attract additional airlines, routes and flight frequencies have increased as divested airports have competed on the strength of their individual attractions to airlines and passengers rather than acting as part of the BAA group. Airports previously focusing on LCCs or short-haul flights because of BAA's segmentation of the market among its airports are now competing for full service carriers and long-haul international routes. Under common ownership airports had less incentive to compete in such a way as additional routes and passenger volumes at one airport would have cannibalised sales at the other airports.

(e) **Level of airport charges**: Both Gatwick and Stansted have agreed long-term competitive deals for airport charges with their major customers. Some point to point airlines not constrained by the configuration of existing network operations or large sunk costs at airport bases have seen lower airport charges. However, several stakeholders cited capacity constraints in the South-East as limiting options for airlines to switch airports and a consequent limitation of their negotiating power.

(f) **Structure of charges**: Airports have altered the structure of their airport charges to airlines in order to become more competitive for example offering seasonal discounts and incentives for larger, fuller aircraft.

(g) **More efficient use of existing capacity**: Restructured airport charges have attracted additional flights during quieter periods and increased the efficiency of aircraft utilisation. Rivalry has led to the more efficient use of existing capacity, particularly at Gatwick. This has contributed to the observed increase in passenger throughput.

(h) **New capacity**: The CC considered that BAA's common ownership of the three major airports in the London area appeared to have exacerbated delays in the delivery of runway capacity and noted BAA's reluctance to press for more runway capacity. Under separate ownership competition for the allocation of new runway capacity has increased considerably. Information on expansion options provided to ministers has been comprehensive with detailed bids from Heathrow and Gatwick.

(i) **Airport community stakeholders**: Airports cite stronger relationships with, and more efficient use of, government resources at border control, and better engagement with local communities.

5.101 The CMA considers that the divestment remedies in the South-East were a significant enabling factor influencing progress across these nine important areas. The competition landscape in the South-East changed significantly following the divestment remedies. Separate ownership of Gatwick and Stansted, together with Heathrow's new management focus have led to considerable passenger benefits already. Given that the divestitures happened only recently (eg Stansted was divested in 2013), we consider that these benefits will continue to accrue over time and become more measurable. The nature of the improvements observed are generally in line with the CC's expectations with some indication of positive changes over and above those anticipated by the CC.

5.102 Whilst Heathrow, Gatwick and Stansted have made progress in utilising existing capacity through innovation and process improvements, the potential for further route development and passenger growth is limited by capacity constraints. Hence the CMA considers that the capacity constraint issues in the South-East are hindering the passenger benefits made possible by these airports being under separate ownership.

Impact of divestment remedy in Scotland

Overview of qualitative evidence

Introduction

5.103 As discussed in paragraph 3.29 and Appendix 2, the CC envisaged that there would be an increase in competition following the divestment of either Edinburgh or Glasgow.[102] This was expected to lead to benefits in four areas:

(a) possible discounts on services;

(b) new routes;

(c) capacity developments; and

(d) service levels gradually being more closely aligned with customer interests.

5.104 Evidence was gathered from a range of different stakeholders including Transport Scotland, two airlines, Edinburgh and Glasgow - and the respective owners of these airports. All of them except for Glasgow suggested a range of benefits and improvements have taken place as a result of the divestments.

Views of Edinburgh

5.105 Edinburgh noted that following its divestment there had been developments in relation to negotiations with airlines and route development, improved service quality, increased efficiency and faster decision making.

5.106 Edinburgh told us that under BAA ownership negotiations with airlines were conducted at a Scottish level as opposed to airport level which left no room for price competition between airports. Under BAA ownership Edinburgh was therefore not able to make offers to airlines independently. Edinburgh described the approach to route negotiation under BAA as removing its opportunity to address the airport's under-representation in the outbound leisure segment of the market. Edinburgh also told us that BAA had had an incentive to use Glasgow's significant spare capacity. As a result, long-haul international flights predominantly operated from Glasgow when BAA owned and operated both these airports.

[102] BAA opted to sell Edinburgh to GIP in April 2012.

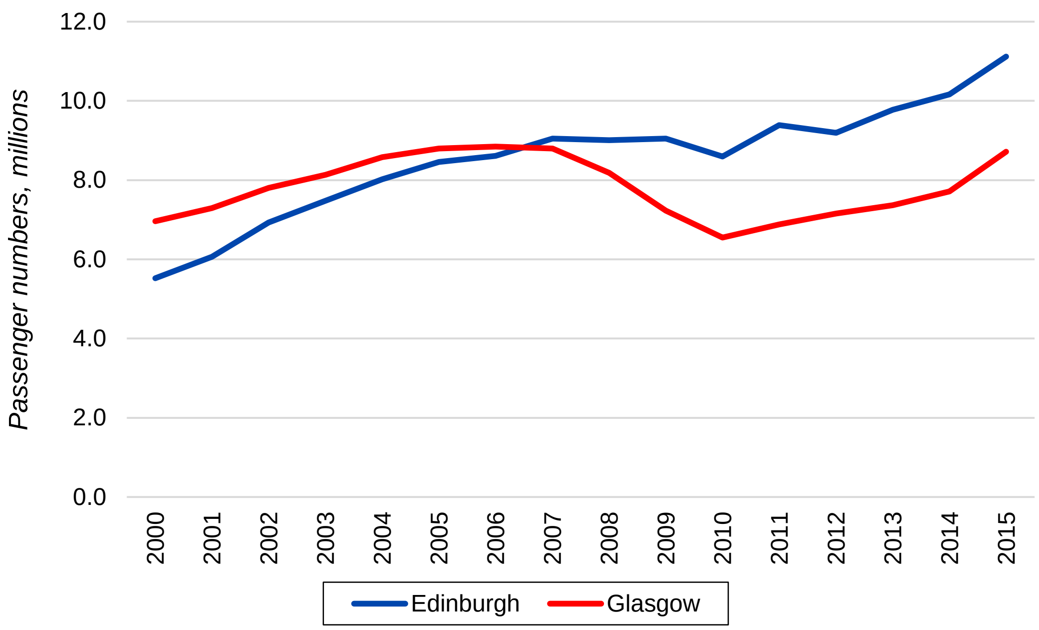
5.107 Negotiations with airlines at Edinburgh now encompass volume and price considerations and can result in growth deals, which were unusual under BAA ownership. Under new management Edinburgh saw itself as actively competing with Glasgow for market share, and had begun to address under-performance in its leisure offer. Edinburgh emphasised that there was significant overlap between Edinburgh's and Glasgow's catchment areas and that this overlap had become even greater with improvements in the public transport system serving Edinburgh. Edinburgh told us that it was now able to stress to potential airline customers the attractive characteristics of its catchment area such as the economic outperformance of the east of Scotland and the opportunity for airlines to access demand for routes between European cities. Edinburgh said that this was restricted under BAA management. In order to support commercial discussions with airlines Edinburgh had increased the size of its route development team from one member of staff and Edinburgh's CEO, to four dedicated full time employees supported by significant input from a further two personnel. Edinburgh's new approach to airline discussions had increased the presence of long-haul routes from one in 2012, to eight by summer 2016, and Edinburgh expects to add further long-haul routes in the near future.

5.108 As part of its new strategy, Edinburgh has actively sought to highlight recent rates of passenger growth and its position as Scotland's largest airport on this measure.[103] Figure 5.7 shows the relative positions of Glasgow and Edinburgh based on annual passenger numbers.[104]

---

[103] See for example Edinburgh airport press release, 30 March 2016.
[104] Passenger numbers at both airports appear to have been influenced by macroeconomic trends during the global financial crisis. The greater change in Glasgow's growth rates relative to Edinburgh is likely to be due to the higher proportion of leisure traffic within Glasgow's passenger mix.

Figure 5.7: Passengers at Edinburgh and Glasgow, 2000 to 2015



Source: CMA analysis of CAA data.

5.109 In relation to service quality improvements, Edinburgh pointed to the following examples:

(a) Improvements in check-in: Edinburgh told us it had introduced significant innovation at check-in. Edinburgh is now using a combination of different operational processes and self-service kiosks allowing it to handle more than 11 million passengers while offering reduced charges to airlines and incurring lower airport operating expenditure. This is in contrast to the old check-in area capacity which was constructed for 6 million passengers. See the case study at Figure 5.8 below for further details.

(b) Increased choice of retailers: Edinburgh has increased space allocated to its retail offer by between 40% and 50% and is now offering more choice for passengers. Edinburgh said that under BAA ownership contracts with retailers were negotiated centrally which, for example, led to a single coffee provider per airport. New management had increased passenger choice by the introduction of a further three coffee retailers.

5.110 In terms of efficiencies, Edinburgh mentioned the examples of car parking facilities and airport accommodation in addition to the changes to check-in discussed in our case study at Figure 5.8 below.

(a) Edinburgh said that historically the airport had offered a single price for car park parking on site irrespective of the duration of stay. Car parks were full during the summer, but operated at around 30 to 40% utilisation during off-peak periods. Following changes implemented by new

management, passengers are able to purchase parking through 11 sales channels and promotional rates are also available. The change in pricing strategy has increased utilisation of the car park and has also allowed Edinburgh to reduce the operating cost associated with its coach service.

(b) In relation to hotel accommodation, Edinburgh had created a revenue sharing model to align interest of the airport and providers, and a hotel development programme to make better use of non-operational land. According to Edinburgh, this was in contrast with BAA's approach of holding non-operational land at group level and making central decisions that Edinburgh suggested may have been inefficient.

5.111 Finally, Edinburgh made reference to faster decision making under new ownership and told us that under BAA there was a sense of inertia and it was difficult to get traction for new ideas. The dominance of Heathrow within the organisation had led to a view that changes at other BAA airports needed to also work for, or be led by Heathrow, which created diseconomies of scale. Edinburgh told us that it was now able to modify facilities and operations based on local needs, for example it had made changes to security processes which reduced costs per passenger.[105] Management told us it had taken 18 months to complete the changes including an extension to the terminal building. This was in contrast to the extension that had taken place under BAA which Edinburgh indicated had taken around five years.[106]

[105] Edinburgh referenced the opening of a new security area that was processing 800 trays per hour per lane compared with 280 under previous arrangements in this context.
[106] Concept initiated in 2005; detailed designs and approval in 2007; opened mid-2010.

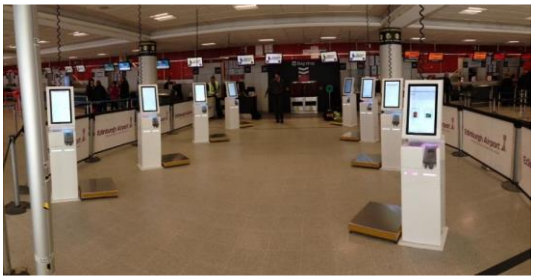
Figure 5.8: Case study – Innovation at Edinburgh check-in

Since 2012 Edinburgh has undergone significant change. New management characterised its strategy as significantly different from the approach under BAA ownership, which it described as unsupportive of improvements designed to increase competition between Edinburgh and other airports. This new approach is illustrated well by innovations introduced at check-in.

The check-in area at Edinburgh was constructed for 6 million passengers. BAA had identified the need for additional check-in facilities prior to the change of ownership because passenger numbers had risen. The physical configuration of the check-in hall, however, had led to BAA estimates of £12 million for expansion, which was considered too high by new management.

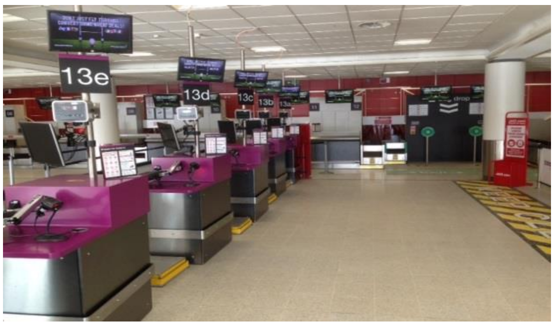
By adopting a combination of different operational processes and new self-service kiosks, Edinburgh's new check-in is now handling more than 11 million passengers while offering reduced charges to airlines and incurring lower airport operating expenditure. The upgrade delivered a 33% increase in capacity for 5% of the cost estimate under BAA.

New common bag drop kiosks



Edinburgh identified that access to GIP's know-how had enabled it to isolate the pinch point in the check-in process and increase capacity through changes to working methods. These include opening desks earlier, conducting non-check-in related customer service away from the baggage injection point and the introduction of new self-service bag drop facilities and 'mobile' check-in kiosks that use much less floor space. This has allowed the check-in area to process a significantly larger volume of passengers without extending the floor area.

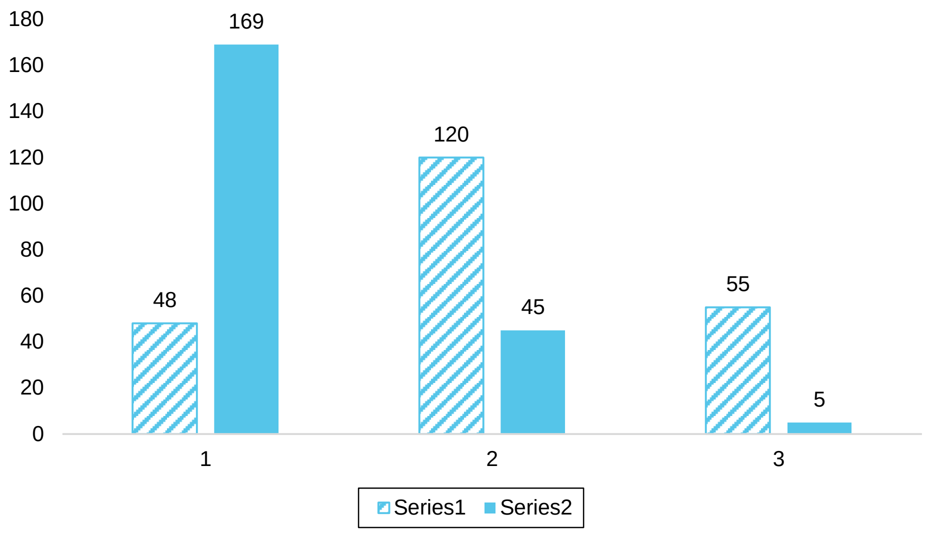
New 'mobile' check-in kiosks



Under new arrangements self-service baggage kiosks and mobile check-in kiosks are used by multiple airlines, unlike at many other UK airports. Airlines are charged on a 'per-use' basis, which can be cheaper than paying by the minute for conventional desks, for which airlines incur charges whether they are serving passengers or not. Self-service and mobile kiosks are now used by around 60% of passengers.

Using the space made available by changes to operating methods Edinburgh is able to offer a differentiated level of service to airlines which chose to provide staffed check-in desks. One airline still requires a full array of six airline-branded serviced check-in desks, with separate desks for premium passengers, and the area dressed with a red carpet.

Innovative efficiency improvements before and after changes



Source: CMA analysis of figures from Edinburgh.

Views of other stakeholders

5.112 Transport Scotland also noted a range of positive developments at Edinburgh. Overall it considered that the Scottish aviation market greatly benefited from the divestment remedy particularly in the central belt, and that Scotland was now in a better position in terms of connectivity than it used to be or would have been without divestment. Specifically it noted that Edinburgh would not have started to develop into a Scottish hub airport under previous ownership.

5.113 There was consensus among stakeholders that for many years the running of BAA's three Scottish airports[107] took a centralised, Heathrow-centric approach. Most decisions were taken at the head office and due to the size of Heathrow relative to the other airports, Heathrow had most focus and attention. However, Glasgow pointed out that after the CC market investigation BAA had started to de-centralise the group in 2010/11, allowing

[107] Glasgow, Edinburgh and Aberdeen.

commercial deals for non-aeronautical services to be made and allowing airports to be more self-sufficient and adaptable to their local markets.

5.114 Like Edinburgh, Transport Scotland noted the faster implementation of infrastructure changes; terminal expansion; improvement of car parking facilities; and the development of Edinburgh's security hall. Aside from these observations it also noted greater development of international routes which it considered that BAA had little interest in because of its focus on Heathrow. Furthermore Transport Scotland stated that, compared to BAA, Edinburgh had a more active relationship with various stakeholders including Scottish Enterprise, VisitScotland and generally greater consultation with airlines.

5.115 Only two airlines we spoke to made comments about the impact of the divestments in Scotland. One airline pointed out that under BAA, the role of Glasgow and Edinburgh appeared to be set: Edinburgh was predominantly the airport for business traffic and Glasgow was the airport for leisure traffic. Since the divestment of Edinburgh, this arbitrary differentiation has begun to unwind. However, the airline also considered that the catchments of Edinburgh and Glasgow were relatively discrete which was likely to limit the extent to which competition could develop between these two airports.

5.116 A second airline made comments that GIP's takeover of Edinburgh meant that the airport was now operating more efficiently and effectively. In addition it argued that greater price pressure was now likely between Edinburgh and Glasgow on routes that could be switched easily by airlines.

5.117 By contrast, Glasgow was less positive about the divestment of Edinburgh. Glasgow told us that as a result of BAA's sale of Edinburgh it had lost access to specialist skills in infrastructure maintenance and economies of scale. In addition there had been an 18-month period of staff speculation and uncertainty after the CC decided on the divestment remedy as it was not known whether BAA would choose Glasgow or Edinburgh to be divested.

5.118 Glasgow said that in recent years it had increased its focus on customer experience and investment which had resulted in an increase in customer satisfaction. However, it pointed to factors other than the sale of Edinburgh as influencing this including the Commonwealth Games held in Glasgow in 2014 and the use of a customer charter in 2012 with commitments to improve passenger experience.

Unintended consequences

5.119 A number of stakeholders expressed views on unintended consequences of the remedies in relation to Prestwick Airport which had lost Ryanair flights and passengers to Edinburgh. However other stakeholders said this was not unexpected given the airport's location and the fact that it had not been performing well prior to Edinburgh and Glasgow competing more actively. In addition Prestwick's decline was explained by a lack of variety of airlines (heavy reliance on Ryanair) and a change in strategy of low cost airlines to move routes to primary airports from regional ones. Furthermore, Prestwick had relied heavily on freight and Scotland had seen a decline in freight traffic due to changes in the manufacturing industry.

Main findings of ICF's analysis

5.120 As discussed in paragraph 5.85, ICF used a range of evidence, including stakeholder interviews and numerous data sources, to analyse the impact of the CC's remedies. In the following paragraphs, we summarise the main findings of ICF's quantitative analysis in relation to the divestment of Edinburgh.[108]

Passenger numbers and ATMs

5.121 As Figure 3.4 of ICF's report shows, the rate of passenger number growth has increased since BAA sold Edinburgh. The data also shows that growth in passenger capacity at Edinburgh has mainly been driven by ATMs to non-EU destinations. This is consistent with Edinburgh's increased focus on international route development as noted in paragraph 5.114. Figure 3.7 of ICF's report also suggests that Edinburgh's share of passenger traffic among Glasgow, Edinburgh, Prestwick and Aberdeen has increased modestly since its divestment.

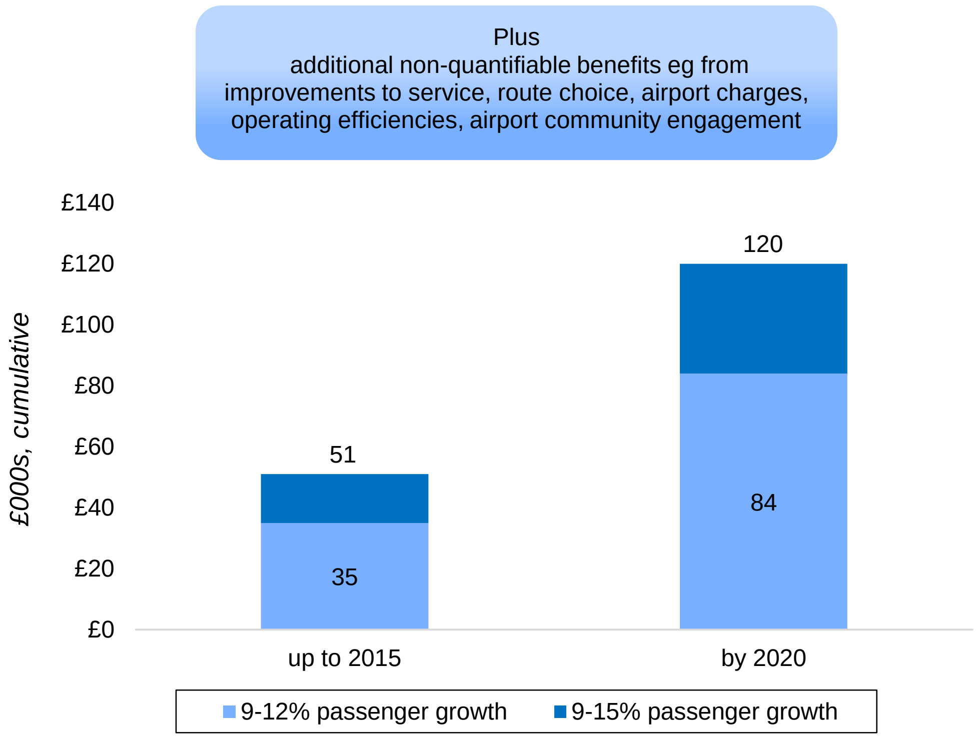
5.122 As discussed in paragraph 5.87, ICF also undertook econometric analysis to test whether positive changes in overall ATMs and passenger numbers at the divested airports, including Edinburgh, were above that which would have been expected in the counterfactual scenario. The results of this analysis suggest that increases in ATMs and passenger numbers at divested airports have been significantly larger compared with other UK airports. More specifically, the analysis showed that ATMs of the three divested airports, including Edinburgh, were on average 9% higher than the ATMs of the control group, while passenger numbers were on average 9 to 12% higher compared with the control group, after taking into account long-term trends and airport-specific characteristics. ICF estimated that this change in passenger number

[108] ICF report.

translates into £35 million of consumer benefits for the period 2009 to 2015 with further benefits expected in the future.

5.123 With another model specification, in which Heathrow and Glasgow were omitted from the control group, ICF's analysis found that passenger numbers at divested airports were as much as 15% higher on average in the period following separate ownership when compared with the control group. If these partial benefits continue to accrue at the annual level quantified for 2015 using ICF's higher estimate of 15% passenger growth at divested airports, estimated cumulative nominal benefits for the period 2009 to 2020 would total £120 million in Scotland as shown in Figure 5.9.

Figure 5.9: Estimated consumer benefits from estimated passenger throughput at Edinburgh



Source: CMA summary of ICF's analysis.

Service quality

5.124 ICF's analysis of ACI's passenger satisfaction data at Edinburgh revealed that passenger satisfaction at Edinburgh had shown a mixed trend between the divestment and the end of 2015 including a marked dip during 2013. Edinburgh pointed out that this decrease in service quality perception had coincided with a reconfiguration of its security hall and that issues had been resolved.

5.125 ICF also planned to carry out econometric analysis of service data to explore whether there was any statistically significant change in passenger perceptions around the time of divestments of BAA's airports. However insufficient ASQ data were available to ICF[109] to carry out this analysis.

Airport charges

5.126 Using data between 2000 and 2013, ICF examined total aeronautical revenue and aeronautical yields per passengers to assess the impact of the remedies on airport charges. However, as noted in paragraph 5.96, it was not feasible to undertake a comparison via regression to assess the impact of the remedies on airport charges.

Overall conclusion of ICF's analysis for the divestment remedy in Scotland

5.127 ICF sought to estimate changes that could be attributed to the CC's remedies in lowland Scotland. ICF's analysis revealed that, for most indicators, current data are not sufficient to supplement the findings from the qualitative evidence which suggest improvements have commenced at Edinburgh in route development, service quality and efficiency. Nonetheless, ICF's analysis provides econometric evidence of a significant increase in passenger numbers and ATMs at the divested airports, including Edinburgh, following divestment compared with a control group, taking into account long-term trends and airport specific characteristics.

Summary of findings in relation to lowland Scotland

5.128 Since new ownership in 2012 Edinburgh has undergone significant change. The airport has adopted a new commercial and innovative focus that has already resulted in benefits to passengers through increased choice of routes; and operational and service improvements. Stakeholders, including airlines noted operational and route development improvements at Edinburgh. Edinburgh's new strategy contrasts with BAA's historic approach to positioning Edinburgh as predominantly a business airport and since its divestment it has been actively competing for both business and leisure traffic. Edinburgh is starting to develop into a Scottish hub airport and generating benefits in the form of increased regional and international connectivity.

5.129 Glasgow has increased its focus on customer experience in recent years with the introduction of a customer charter in 2012. Other strategic change at

---

[109] ASQ data are not published by ACI and while some airports publish aspects of their individual performance, this information is limited.

Glasgow since the CC investigation appears to have been incremental. The airport was sold by Heathrow Airport Holdings (previously BAA) to AGS Airports Limited in December 2014 and this may affect Glasgow's continuing strategy, including responses to changes at Edinburgh.

Impact of behavioural remedies in Aberdeen

5.130 Aberdeen's geographical position is comparatively isolated relative to other parts of Scotland. In its final report the CC noted that airlines did not view other airports as substitutes for Aberdeen and considered their main airline competitors on Aberdeen routes operated from Aberdeen rather than other airports. In addition, an important part of Aberdeen's position is that it is a centre for the offshore oil industry.[110,111] As such it is strongly affected by the oil industry and changes in oil prices. For further context on how the oil price affects the aviation industry see Section 4.

Overview of remedies

5.131 The undertakings, which came into effect in 2011, cover two aspects.

(a) First, Aberdeen is subject to a reporting remedy. This involves a requirement to publish annually a set of audited accounts with segmental analysis by type of traffic and non-aeronautical activity as well as information on assets, revenue, costs and profits on a replacement cost basis. Data on airport charge yields by airline must also be made available to the CC (now CMA) and to the CAA.

(b) Second, Aberdeen is subject to a consultation undertaking. This involves a requirement to consult annually with airport users and other relevant stakeholders on Aberdeen regarding its prospective capex programme.

5.132 Compared with other remedies implemented there are a smaller number of affected parties. Nevertheless we have made every effort to interview relevant stakeholders in order to gather as full a picture as possible on the effect of the undertakings.

Aberdeen's views

5.133 Aberdeen Airport told us that little or no response was received when the required information was published and it considered the consultation

[110] 2009 report, p89, paragraph 3.147.
[111] As expanded upon in section 3 3.16.

requirements to be burdensome due to the formalities within the remedy.[112] Aberdeen also said that consultation information was not in the format stakeholders wished to receive[113] and suggested a slide deck would be preferable. Aberdeen said this would be in line with the process at other airports and would be a more efficient and effective format of consultation. Information provided by Aberdeen on the cost of meeting the requirements of the CC's remedy is included in Section 6.

Other stakeholders' views

5.134 The CAA considered at the time of the CC investigation that it would have been heavy handed to impose detailed price regulation at Aberdeen. In its recently published monitoring report the CAA said that the undertakings allowed ongoing monitoring of Aberdeen's pricing and profitability by the CMA and the CAA, and allowed airlines (and other stakeholders) to observe average (but not relative) prices. With respect to the effectiveness of the Aberdeen remedy, the CAA said that it hoped its report helps airlines get a more transparent understanding of Aberdeen airport's business and that they use this in their commercial engagement with the airports. The CAA also said it encouraged stakeholders to provide any views they may have on how the CAA could better use the information provided by the remedy, and how that would translate into benefits for consumers. Finally the CAA said it continued to be of the view that there was not enough evidence to justify, at this stage, a more intrusive form of price regulation or even a stronger form of oversight. For further details of the CAA's monitoring of Aberdeen see the report published alongside this evaluation, accessible on the CAA's website.[114]

5.135 One airline, Flybe, told us that the monitoring information provided by Aberdeen was likely to be useful for preparations it would make in anticipation of contract renewal negotiations with the airport. In particular Flybe considered levels of return on capital employed and an idea of projected capital spending were metrics it could use to develop a greater understanding of the profitability of the airport.

5.136 Flybe told us that its procurement director would use this information prior to negotiation to develop knowledge of aeronautical and non-aeronautical revenue streams in order to develop a greater understanding of the airline's own bargaining power. It also commented that the presentation of the

[112] Aberdeen is required to distribute the full rolling five-year investment cycle on an annual basis.
[113] Aberdeen Airport suggested that it would be more sensible to produce the full investment plan upon request only.
[114] See CAA (2016), *Aberdeen Airport - a market monitoring report*.

segmented reporting worked well and was useful to challenge spending on capex which had potential to lead to lower charges.

5.137 Flybe also commented that consultation with airlines in general was useful as a structure to facilitate discussion for better outcomes, but would prefer certain enforcement measures if consultation was not producing fair outcomes.

Unintended consequences

5.138 No stakeholders raised any examples of unintended consequences arising from the remedies at Aberdeen.

Main Findings of Quantitative Analysis

5.139 ICF's analysis found some evidence that the rise in airport charges and operational expenditure has slowed since the undertakings were accepted. However no quantitative or qualitative evidence was found linking this with the CC's remedies.

Conclusions on Aberdeen

5.140 The relatively 'light touch' remedies for Aberdeen are intended to reflect Aberdeen's ability to exercise its market power, which derives in part from its geographic location. The remedies do this by providing the industry regulator and the competition authority with information about Aberdeen's financial performance and by ensuring Aberdeen provides information to its stakeholders and consults them periodically on its strategic plans.

5.141 In order for these remedies to be effective it is important that the CAA and the CMA continue to actively monitor compliance. We welcome the CAA's recent publication of its monitoring report on this remedy and would suggest this exercise is repeated on at least a two-yearly basis. It would be desirable if Aberdeen was more proactive in promoting the monitoring information it provides to its customers which would in turn enable them to be actively engaged in considering and acting on this information.

5.142 Figures reported by Aberdeen do not indicate clear trends in its financial performance during the period covered by the remedies. However, we note that the recent downturn in the oil sector is likely to affect Aberdeen and its users. Further monitoring will indicate how relevant this is for future assessments of Aberdeen's market position.

5.143 Although many airlines do not appear to have focused on the specifics of the undertakings, one of Aberdeen's larger[115] airline customers told us that the information would be useful in upcoming contract renewal negotiations.

5.144 As such, there is some limited evidence that the behavioural remedies at Aberdeen are, as intended, providing some additional accountability to the regulator and for Aberdeen's customers.

[115] This airline (Flybe) was Aberdeen's second largest fixed-wing customer accounting for 14% of Aberdeen's fixed wing passenger traffic in 2015. See CAA (2016), *Aberdeen Airport - a market monitoring report*, p10, Figure 3.

6. Costs and proportionality

Remedy implementation and monitoring costs

6.1 As part of our evaluation we examined the costs of implementing the CC's remedies for two reasons. First we sought to compare the actual costs of implementing the remedies with those envisaged by the CC and BAA at both the time of the 2009 market investigation and when revised estimates were made during the material change of circumstance (MCC) review in 2011. Second, we used cost data while considering the proportionality of the CC's remedies in light of the benefits to date. We also considered monitoring costs associated for Aberdeen.

Divestment remedies

6.2 BAA's divestment of Gatwick, Stansted and Edinburgh had the potential for a variety of different types of costs. In this evaluation, we focus mainly on separation and transaction costs. We also considered other types of costs, including those relating to any potential loss of economies of scale, however stakeholders told us that economies of scale were not significant across airports and therefore these costs had been immaterial. The following table provides background to the cost categories considered by the CC and those submitted by BAA during the investigation, together with clarification of which costs we consider to be relevant for the purposes of this evaluation.

Table 6.1: Cost categories

Type of cost	Explanation/examples	CMA relevance for this evaluation/feasibility
Separation costs	These relate mainly to IT expenditure to prepare a new stand-alone business. Other separation costs relate to non-IT costs including termination payments for staff.	This was the focus of the CC and hence it is our principal focus.
Transaction costs	These relate to fees paid to advisers (financial, legal, accounting, public relations), and expenditure relating to credit rating agencies and other third parties (including the MT) incurred during the transaction.	Whilst the CC did not consider these due to the absence of substantiation by BAA, they are of interest to our evaluation for lessons learnt and for proportionality considerations.
Pension costs	Any pension liability costs at the time, based on actuarial valuations.	These are not relevant. They would be reflected in the purchase price and/or resolved by the seller prior to the sale process.
Changes in economies of scale related to common ownership	Cost savings from shared service functions, corporate running costs and sometimes from purchasing power benefits.	We received qualitative feedback stating economies of scale related to common ownership were not considered to be significant.* Some stakeholders suggested that diseconomies of scale may have existed. It has not been feasible to quantify either economies or diseconomies in this evaluation.
Impairment costs	Sale proceeds below accounting book value of assets arising from timing influences and/or valuation considerations.	These are not relevant. The CAT concluded that the CC's approach aimed to eliminate as far as possible the risk of depleted sale proceeds.**
Acquirer costs	The costs incurred by the purchaser (in this case GIP and MAG).	These are not relevant. They would be reflected in the purchase price, ie taken into consideration by the buyer when deciding what price to pay for the acquisition.

Source: CMA.
*Gatwick told us that it did not believe there had been any passenger detriment arising from loss of economies of scale following the divestment.
** See CAT judgment, 21 December 2009, paragraph 259.

Separation costs

6.3 The following table illustrates how actual separation costs differed from estimates. Estimated figures derive from two sources: (i) BAA's estimation of separation costs provided during the 2009 investigation, and (ii) the assumptions used by the CC in the 2009 report when considering proportionality. These are lower than BAA's figures because the CC considered that BAA's estimates were inflated.

Table 6.2: Comparison of separation costs by airport

	Gatwick	*Stansted*	*Sub-total South-East Airports*	*Edinburgh**	*Total separation costs (all three divested airports)*
BAA estimate	£44.5m	£44.8m	£89.3m	£16.8m	£106.1m
CC estimate	£27.6m	£23m	£50.6m	£12.2m	£62.8m
Actual	£36m	£11m	£47m	£11m	£58m
% difference BAA estimate vs actual	24%	307%	90%	53%	83%
% difference CC estimate vs actual	-23%	109%	8%	11%	8%

Source: CMA analysis of actual costs supplied by Heathrow in correspondence to the CMA on 4 Feb 2016, updated by Heathrow on 10 March 2016. BAA and CC estimates taken from Table 1, Appendix 10.3 of the 2009 report.
*At the time of the investigation, BAA supplied estimated costs for Glasgow rather than Edinburgh.
Note: Original estimates relate to 2008, MCC costs relate to July 2011.

6.4 The table shows that in aggregate the CC estimates were much closer to the actual costs incurred than BAA's estimates. The CC's assumption for the three airports divested was 8% higher than actual separation costs incurred. This contrasts with BAA's forecasts which amounted in aggregate to an 83% over-estimation.

6.5 Heathrow explained to us why the costs of separation at Stansted and Edinburgh were much lower than those at Gatwick. This partly reflects the relative size of the airports, but is also explained by the order of the divestments. Learning captured from the experience of selling Gatwick reduced the marginal complexity of IT separation costs: for example, by the time that Stansted was sold, the airport had continued to move closer to being a stand-alone business. This reduced the costs of separation.

6.6 Based on this comparison of actual costs with projections made at the time of the CC's interventions, it appears that the CC was correct to question BAA's cost projections. The CC had to contend with a clear asymmetry of information when setting its estimates regarding the likely actual level of costs compared with BAA. Despite this it appears that the CC was right to be cautious, and sensible estimates were made by the CC. The CC reduced BAA's estimate of separation costs by a substantial 41%. The out-turn costs were even lower.

Transaction costs

6.7 The CC did not take account of transaction costs due to BAA's limited justification of these. Hence there were no estimates of transaction costs made by the CC in the 2009 report. At the time of the MCC review, however, BAA knew the level of transaction costs it had incurred with the Gatwick sale (£20 million), and used these to estimate that transaction costs would be in the order of £20 million at Stansted. Actual transaction costs were £7 million and £10 million for Stansted and Edinburgh respectively.[116]

6.8 On the one hand this could be considered further evidence that BAA had some incentive to overstate the costs of a remedy that it did not support.[117] Alternatively it may reflect inaccurate forecasting in that BAA did not recognise that Stansted's sale would proceed with much lower transaction costs than those incurred at Gatwick. This was arguably predictable however, given the lessons learnt from Gatwick (see earlier). Heathrow told us that the revised corporate structure of BAA was less head office centric post Gatwick's divestment and that this contributed to lower transaction costs when Stansted was sold in 2013.

Impairment costs

6.9 Heathrow suggested that it had incurred £225 million of impairment costs associated with the economic conditions[118] prevailing at the time of the Gatwick sale in 2009. This value was estimated by Heathrow based on a comparison of the sale price to the accounting book value of Gatwick's asset base. It did not provide an estimate of the relative valuation for Stansted and Edinburgh, which many observers have suggested were made at a premium price.[119]

Acquirer costs

6.10 In terms of acquirer costs, both Stansted and Gatwick, together with their respective new owners (MAG and GIP), said that their separation from BAA had been completed below cost and ahead of time envisaged. This is consistent with stakeholder views that the CC's purchaser evaluation criteria had worked well and allowed transactions to progress smoothly (see Section 7).

[116] As supplied to the CMA by Heathrow in February 2016.
[117] Our market investigation guidelines (CC3) state that in evaluating cost information the CMA will bear in mind that it has less information than parties have about how such potential costs have been estimated and that there might be incentives for parties to overstate the cost of those remedies that they do not support. See CC3, paragraph 352 (b).
[118] The way in which economic conditions affected the availability of debt financing is discussed in Section 7.
[119] Profit on disposal for Stansted and Edinburgh amounted to £147 million and £38 million respectively. See Heathrow Airport Holdings Limited Annual report and financial statements for the years ending December 2013 and 2014 p12 and p8 respectively. MAG recognised goodwill of £166 million on the purchase of Stansted. See MAG Annual report year ending March 2013, p25.

Financing costs

6.11 In addition to expecting remedy benefits for consumers and other airport users, the CC said that following divestiture of Gatwick and Stansted it was reasonable to believe that the level of financial risk faced by these airports would reduce.[120] This was because divested airports would not be reliant on the single highly geared capital structure of BAA that was in place at the time of the CC investigation.

6.12 During our evaluation one stakeholder suggested that we consider whether the CC's significant intervention might instead have increased the level of financial risk for UK airports. This stakeholder noted the common view that smaller companies find it harder to access capital markets and raised the question of whether investor confidence in the UK airports market might have been influenced by the CC's divestment remedies.

6.13 Evidence gathered during our evaluation indicates that both debt and equity investors have remained supportive of the UK airports sector since the CC's remedies were put in place.

(a) A financial institution told us that innovation and new thinking were released as a consequence of the CC's divestment remedies and new ownership. This had contributed to making UK airports increasingly attractive to debt and equity investors. This financial institution said that debt from Heathrow and Gatwick had been sold to at least 600 different investors around the world. In this financial institution's opinion there was now greater diversification when it came to the type of debt investors in the three divested airports and Heathrow. This financial institution told us that debt investors were attracted to the different commercial strategies and business profiles of Gatwick, Stansted and Edinburgh as stand-alone companies. This financial institution also noted that while it was not possible to say that the CC's remedies had reduced financing costs for UK airports, it was of the view that the cost of capital had not been negatively affected by CC intervention in the long run.

(b) We also note that since the time of the CC's final report, the number of shareholders in the corporate entity that was BAA has increased from three in 2009 to seven in 2015. New equity investment occurred in each of the three years during the period 2011 to 2013, and new equity derived from investors based in the USA, Qatar, Canada, China and the UK. Taken together these developments indicate that Heathrow has been

[120] 2009 report, paragraph 10.360.

regarded as an attractive equity investment opportunity since the implementation of the CC's remedies.[121]

6.14 We also note that the DfT's estimate of a total benefit of £195 million over 20 years from reforms to economic regulation of airports largely derives from an expectation of lower levels of risk resulting in a lower level of the cost of capital for airports under the CAA12 regulatory framework.

Behavioural remedies at Aberdeen

Requirement for accounting separation

6.15 As noted above, under the terms of the remedy Aberdeen is required to publish accounting information. Aberdeen publishes most of this information on its website,[122] except for airline specific yield information which is only submitted to the CMA and CAA.

6.16 Aberdeen told us that the revised presentation of the year end accounts was done only for the purposes of complying with the remedy and was not used for other purposes by management. Aberdeen said that each year it took the equivalent of two full time equivalent posts approximately two weeks to adapt the year end accounts to a version based on the separate accounting format, as specified by the CC undertakings. We do not consider this to be too onerous.

6.17 The CAA told us that its costs relating to monitoring the undertakings at Aberdeen were not considered significant at around £10,000 a year.[123]

Format of capex consultation

6.18 Under the terms of the remedy Aberdeen is required to consult at least annually with airport users and other relevant stakeholders regarding its prospective capex programme. The undertakings provide this would involve:

---

[121] At the time of the CC 2009 report, BAA's majority shareholder was Ferrovial (with a shareholding of 55.9%) and the balance of shares were owned by Britannia Airport Partners LP (26.5% and Baker Street Investment Pte Ltd (17.6%), see *BAA Limited - Annual report and financial statements for the year ended 31 December 2009*, p64. The corporate entity that was BAA is now Heathrow Airport Holdings Limited having been renamed in 2012. In 2015 Ferrovial remained the majority shareholder in Heathrow Airport Holdings Limited (with a shareholding of 25%) and the balance of shares were owned by Qatar Holding Aviation (20%), Casse de dépôt et placement du Québec (12.6%), Baker Street Investment Pte Ltd (11.2%), Alinda Airports UK L.P. and Alinda Airports L.P. (11.2%), Stable Investment Corporation, China (10%) and USS Buzzard Limited (10%). See *Heathrow Airport Holdings Limited - Annual report and financial statements for the year ended 31 December 2015*, p83.
[122] See Aberdeen Airport Website - publications section.
[123] We consider additional CMA monitoring costs are not significant.

(a) the publication of information to airlines on the master plan;[124]

(b) the publication of information to airlines on a summary forward programme of capital projects together with forecast costs and details of individual key projects; and

(c) the creation of a forum for the proposals to be discussed.[125]

6.19 In terms of the capital investment plan consultation undertaking, Aberdeen did not specify the costs of implementation nor provide context to this, but it did comment that the process was burdensome and not in a format that its stakeholders wished to use. These comments predominately relate to the second of the three aspects of the remedy noted above.

6.20 Aberdeen said that stakeholders preferred to have some interaction when plans were presented, for example though slide decks or conference calls. This was sometimes preferred to a detailed line by line investment plan. It is hence possible that Aberdeen is incurring a cost in preparing plans in a format that stakeholders do not wish to receive.

6.21 It is possible that a less prescriptive format for this remedy which allowed for advances in technology and/or best practice to sharing information with airlines could achieve the same result for lower cost. One airline that uses Aberdeen did welcome the CC's remedy. In the absence of specific views from a cross-section of airlines, however, it has not been possible within the evaluation process to assess whether such an approach would be desirable.

Regulation changes

6.22 The CC did not assess the costs of implementing changes to the regulatory framework as the remedy was a recommendation to the DfT.

6.23 The CAA told us that it estimated an additional annual cost of around £200,000 to £300,000 for its work relating to the MPDs it had conducted under CAA12 compared with approximate costs for price control reviews under the Airports Act 1986. It noted that costs in the future were likely to be lower as Stansted is no longer regulated and Gatwick's price licence covers a longer period than previous price controls.

6.24 The DfT produced an impact assessment of the regulatory changes arising from the CC remedies and subsequent CAA12.[126] This suggests the net

[124] See Aberdeen International Airport (2013), *a new approach: Aberdeen International Airport Master Plan 2013*.
[125] See Aberdeen Airport Consultative Committee website.
[126] DfT Impact Assessment.

impact is a £10.7 million a year saving[127] to business and the DfT notes an assumption that this saving will be passed on to passengers. These estimated savings may be conservative since an assumption was made that there would be a series of speculative appeals once the previous automatic appeals process was ended. To date, no such appeals to the CMA have arisen. This same impact assessment highlights a total benefit of £195 million over a 20-year time horizon. Given the interaction between the CC's divestment remedies and the introduction of CAA12, there is likely to be some overlap between ICF's benefit valuation and the DfT figures.

Proportionality of remedies

6.25 Considering whether a remedy is a proportionate response to the competition problem identified is a fundamental aspect of the development, implementation and evaluation of remedies.

6.26 An assessment of proportionality is guided by the following principles. A proportionate remedy is one that:

(a) is effective in achieving its legitimate aim;

(b) is no more onerous than needed to achieve its aim;

(c) is the least onerous if there is a choice between several effective measures; and

(d) does not produce disadvantages which are disproportionate to the aim.[128]

6.27 These principles are applied to judgements about individual measures within a package of remedies as well as to the package taken as a whole. They also apply to structural remedies (including divestments) and behavioural remedies.

6.28 It is worth noting that BAA challenged the CC's application of these proportionality principles and their application to BAA's common ownership structure and in particular to the requirement to sell Stansted. Challenges were made in the Competition Appeal Tribunal (CAT), and BAA's first appeal was taken to the Court of Appeal. Both BAA's appeals were ultimately unsuccessful.[129]

---

[127] DfT Impact Assessment, paragraph 294.
[128] CC3, paragraph 344.
[129] For further details of appeals see Appendix 3.

6.29 This evaluation study can only realistically consider the first and fourth strands of these proportionality principles, that is, those described in paragraph 6.26(a) and (d). Hence we have not sought to gather evidence or interviewed stakeholders to evaluate whether alternative remedies could have been implemented. Making such an assessment now, when the market has evolved since 2009, would be extremely challenging and beyond the scope of this evaluation.

6.30 We considered evidence on the first strand of these proportionality principles, the effectiveness of the remedies, in Section 5. In this section, we consider evidence mainly on the last of the four principles of proportionality – in essence whether the benefits of the intervention exceed the cost. When assessing the costs versus benefits we do so with the benefit of hindsight, albeit acknowledging that not all benefits expected have been quantified and not all benefits have yet accrued. Such assessments of costs and benefits often require a weighing up of short-term costs against longer-term benefits. Many of the costs incurred in implementing a remedy are often immediate, one-off costs incurred by the company subject to a remedy or remedies. The separation of the divested airports is an example of this.[130] By contrast the benefits arising from an effective remedy are likely to endure for a longer period, and may evolve over time as the market develops and competitive forces change. These long-term benefits are mainly for customers, in this case passengers, though it is possible that the company will also benefit from the remedy or remedies.

Qualitative evidence

Views relevant to the divestments in the South-East

Heathrow's view

6.31 Heathrow maintained the stance taken by BAA in expressing the view that the divestments of Stansted and Gatwick were not proportionate. Heathrow said that BAA had never accepted that the CC provided a clear evidence base to support the remedies, it said 'It is not possible to set aside the lack of evidence and causal link between the findings of the CC's market investigation and the remedies it applied, as such, Heathrow's view remains that the CC's remedies were wholly disproportionate to the findings made.'[131]

[130] We note that there are ongoing costs at Aberdeen due to the requirement to publish certain financial and other information each year to comply with undertakings accepted by the CC.
[131] Letter from Heathrow's Regulatory Director to the CMA, dated 4th February 2016.

Other stakeholders' views

6.32 The CAA told us that it had no reason to take a different view on proportionality from its position at the time of the 2009 investigation. In its response to the CC's provisional decision on remedies the CAA said 'The CAA agrees with the Commission that BAA's ownership of Heathrow, Gatwick and Stansted has adverse effects on competition and that structural separation of these three airports is an appropriate and proportionate remedy'.[132]

6.33 Other stakeholders were of the view that the divestments of Gatwick and Stansted were proportionate. Some commented that at the time, the divestment remedies were considered bold. They suggested that as time had passed there was clear evidence of significant improvement at all the major London airports. Hence stakeholders said there could be little doubt that the right decision was made.

CMA's view

6.34 We considered Heathrow's view (see paragraphs 6.9 and 6.31) and noted four factors. First, Heathrow did not substantiate its statement regarding the evidence base considered by the CC with any new analysis or other information. Second, as noted above, BAA made legal challenges to the CC's decision for BAA to divest Stansted, aspects of which related to proportionality.[133] These challenges were not successful.[134] Third, the price paid for Gatwick was driven by the judgment of prospective new owners rather than the historic level of Gatwick's asset base as recorded in the regulatory accounts. In determining the valuation of Gatwick, prospective owners would have evaluated the future growth prospects of Gatwick under new management. The level of the asset base, although relevant to the valuation, would have been of secondary importance in light of the new commercial strategies and operating procedures new owners would employ. It is also possible that prospective owners may have considered that the existing asset base was too high, or not optimally configured for their purposes. Finally Heathrow has provided the CMA with evidence of its

---

[132] CAA response to CC in 2009, p9 & 17.

[133] BAA appealed the CC's decision to the CAT. On 21 December 2009 the CAT found that BAA had failed on its appeal ground (that the CC failed properly to apply the proportionality principles when fixing the timetable for divestment of three BAA airports).

[134] The CAT said 'Of course BAA's specific complaint is not in respect of the imposition of the remedy requiring divestiture of three of its airports as such: its complaint is a narrower one about the timing of that divestiture.' CAT judgment 21 December 2009, paragraph 252. The CAT also said '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'. CAT judgment 21 December 2009, Paragraph 256. The time periods over which divestments were made are discussed in Section 7.

improvements since 2009 and in doing this, has emphasised the benefits of its sole focus on Heathrow, although it did not acknowledge the divestments had contributed to these improvements.

6.35 Unsurprisingly, the new owners and operators of Gatwick and Stansted (owned by GIP and MAG respectively) told us that the remedies were proportionate. However, other independent parties, including the CAA and a former BAA director also commented that the divestiture remedies in the South-East were proportionate given the substantial passenger benefits arising since the remedies were implemented.

Views relevant to the divestment in Scotland

6.36 Transport Scotland, Edinburgh and its owners, GIP, all stated that the remedy for divestment of one Scottish airport was proportionate. Glasgow noted however, that there had been a period of uncertainty and unrest while BAA decided which airport would be divested (see below).

6.37 Transport Scotland told us that the Scottish aviation market had greatly benefited from the divestment remedy, especially in the central belt, and Scotland was in a better position in terms of connectivity than it used to be or would have been without the divestment of Edinburgh.

6.38 In particular, Transport Scotland told us that it was likely that under BAA ownership Edinburgh would not have started to develop into a Scottish hub airport. Transport Scotland also told us that the effect of the divestment remedy on Edinburgh's operations had been significant. Transport Scotland considered the remedy to be proportionate in light of these benefits:

- A more pro-active approach towards route development in general, including the expansion of the route development team.
- An increased focus on international route development and long-haul flights.
- Increased competition for routes with Glasgow.
- Faster implementation of infrastructure changes.
- More active relationships with Scottish Enterprise, VisitScotland and Transport Scotland (including cooperative marketing).
- Improved consultation with airlines.

- Expansion of terminal facilities including security and improvement of car parking facilities.

CC's decision not to specify which Scottish airport should be sold

6.39 The CC's decision did not specify which airport would need to be divested by BAA and the option of either Glasgow or Edinburgh was left to BAA to decide. This was because there was not a sufficiently strong case in terms of competition factors to specify which of BAA's airports in lowland Scotland should be sold.[135] Stakeholders said that this further helped ensure proportionality as BAA could review the relative divestment costs and assess these against the potential sale proceeds from either airport. Although there had been speculation that BAA would choose to sell Glasgow, ultimately it sold Edinburgh to meet the CC remedy.[136]

6.40 Transport Scotland supported the CC's decision not to specify which airport was divested to comply with the remedy requirement.

6.41 Edinburgh also told us that there was no justification for specifying which Scottish airport should be divested and the CC's approach had been correct in this respect. Edinburgh considered that BAA chose not to sell Glasgow, which was widely anticipated, because Edinburgh was the asset that could secure a higher sale price and hence contribute more to BAA's desire to reduce its debt. Liquidity was tight at the time of the divestment and Edinburgh was the more profitable airport.

6.42 Glasgow informed us that the CC's approach had led to some staff uncertainty and speculation until the future ownership regime was clarified. Glasgow said, however, that neither investment nor passengers had suffered during the period up to the decision by BAA to sell Edinburgh.

Views relevant to Aberdeen's behavioural remedies

6.43 Views on the proportionality of behavioural remedies at Aberdeen were limited. The CAA told us it had no reason to take a different view of the undertakings from that expressed at the time of the 2009 investigation when it said in response to the provisional decision on remedies:

> Even if a remedy were needed there is a range of more proportionate remedies that are more likely to improve outcomes and avoid the distorting effects associated with the form of price

[135] See CC press release, p2.
[136] At a later date, Glasgow was sold, independently of CC's remedy process.

> cap proposed by the Commission … the Commission could take action to increase the information available about Aberdeen's conduct, obliging it to publish financial performance data to allow the CAA, OFT and third parties to assess more easily whether its performance is reasonable.[137]

6.44 Whilst Aberdeen suggested that the undertakings were onerous and possibly too restrictive for the consultation processes it would prefer to adopt, it acknowledged that relative to price cap regulation they were low cost, less burdensome and hence more proportionate.

Views relevant to the economic regulation recommendations

6.45 No stakeholder has expressed a view that the recommended changes to regulation were too onerous or disproportionate. As noted in Section 5 of this report, the general consensus is that the recommendations and subsequent reforms have led to new approaches to regulation that have enhanced competition and been beneficial. The estimated costs of implementation are relatively low for the new regime and some regulatory costs are now lower, for example now that Stansted is deregulated.

Quantitative evidence

6.46 At the time of the CC market investigation, the CC's analysis indicated that to equal the estimate of the likely expected separation costs, net benefits of at least £23 million[138] would need to occur at Stansted and at least £27.6 million[139] at Gatwick. Now that actual separation costs are known, the corresponding figures are £11 million at Stansted and £36 million at Gatwick. These revised values reflect the lower actual separation costs at Stansted, compared with the CC's estimate, and the higher costs than envisaged by the CC at Gatwick.

6.47 Based on ICF's quantification of the partial customer benefits for the period 2009 to 2015, the partial consumer benefits quantified significantly outweigh the costs. These benefit estimates are considered conservative. Divestment costs are now complete whereas the benefits arising from divestment are expected to continue and possibly rise in future years. The CC assumed a 30-year time frame for the development of benefits, whereas to date around six

---

[137] CAA response to CC in 2009.
[138] The CC also expressed this figure on a per passenger basis, equivalent to 9 pence per passenger at Stansted.
[139] The CC also expressed this figure on a per passenger basis, equivalent to 7 pence per passenger at Gatwick.

and a half years have passed since the first divestment at Gatwick in 2009.[140] The following table summarises the costs incurred by BAA to divest the airports (the sum of separation and transaction costs) compared with the partial benefits to date and projected partial benefits quantified by ICF.

Table 6.3: Divestment costs and estimated partial consumer benefits, 2009 to 2015[141]

	Costs incurred by BAA (separation and transaction costs)	*Estimated partial benefits to passengers to date*	*Estimated partial nominal benefits to passengers 2009 to 2020*	*Year in which benefits exceeded costs*
Gatwick – divested in 2009	£56m	£207m	£377m	Year 2 post divestment
Edinburgh – divested in 2012	£21m	£35m	£84m	Year 2 post divestment
Stansted – divested in 2013	£18m	£53m	£147m	Year 1 post divestment
Total	£95m	£295m	£607m	2012

Source: CMA analysis of BAA figures and ICF estimates.

Conclusion on costs and proportionality

6.48 BAA incurred costs to allow Gatwick, Stansted and Edinburgh to operate as stand-alone businesses so that they could be divested to comply with the CC's remedies. We compared BAA's actual costs of £95 million with estimates made by BAA and by the CC. This showed that the CC's estimates were close to those incurred and the CC's decision to use its own lower estimate as opposed BAA's projections was well judged.

6.49 We also considered the scale of divestment costs (the sum of separation costs and transaction costs) relative to the value of partial consumer benefits to date quantified by ICF. This comparison indicated that the partial benefits quantified to date, solely from growth in passenger numbers at divested airports, have significantly outweighed divestment costs. Taking into account the timing of costs and benefits quantified, the partial cumulative benefits identified to date had exceeded costs well before the end of 2012. For the reasons discussed above it is clear that substantial benefits will continue to accrue. On this basis, taking a conservative approach (see Figure 1.5) and using only the limited benefits it has been possible to quantify, we estimate that by 2020 the value of consumer benefits would be a factor of six times higher than divestment costs.[142]

[140] In this evaluation we took a conservative approach when choosing the time period for which we calculated benefits. We consider that in the long run other developments (eg changes in the airlines market or technological changes) could have also triggered at least some improvements that have been achieved by the CC's remedies. Therefore, as discussed in paragraph 1.13, we calculated benefits for a period of 11 years (to 2020) as opposed to the CC's 30-year horizon.
[141] Based on ICF's 9-12% estimate of increase in passenger throughput
[142] Taking benefits of £870 million we estimate that by 2020 the value of consumer benefits would be a factor of nine times higher than divestment costs.

6.50 In light of this analysis, which accords with views of the majority of stakeholders, it can be shown that the benefits associated with the CC's divestment remedies have already clearly outweighed the costs of putting them in place.

7. Remedies process

Background

7.1 As part of this evaluation, and to help the CMA learn lessons for implementing future remedies we asked stakeholders for their views in the following two areas:

(a) The process followed by the CC in defining and implementing the remedies, particularly relating to:

(i) transparency and investigation procedures;

(ii) implementation of the divestments and divestment sequencing; and

(iii) the bidder evaluation criteria used by the CC for the divestment process.

(b) The CC's requirement that BAA use an MT to specifically support the three divestments. This role was performed by Grant Thornton. We sought comments on this appointment and the MT's involvement in the process.

7.2 Stakeholders able to comment on these issues were usually those directly involved with or affected by the CC remedies,[143] whereas other stakeholders tended not to be in a position to comment.

7.3 Our focus for this aspect of the evaluation is on lessons learnt, to identify what worked well and what could be done differently in future market investigation remedies.

Transparency and investigation procedures

Transparency

7.4 All stakeholders were complimentary about the transparency of the CC process. Two specific examples stood out:

(a) **Bidder evaluation criteria**: The CC had published the evaluation criteria by which it would evaluate potential bidders and timely feedback was provided to bidders on any weaknesses identified against these measures. This transparency was welcomed since it clearly set out the

[143] These being Heathrow/BAA as the seller, GIP and MAG as the purchasers, various unsuccessful bidders, plus the MT and financial institutions involved in the process.

CC's minimum criteria for an acceptable proposal for consideration by BAA as the vendor. It also provided potential bidders with the opportunity to review their proposals should shortfalls or discrepancies be identified.

(b) **Consultation on and subsequent revision of the proposed remedy at Aberdeen**: Consideration had been given to a price cap remedy at Aberdeen, but representations were received through the CC's consultation which highlighted this approach as disproportionate. The CAA in particular considered the original remedy suggestion to be too burdensome relative to the issues identified. Following consideration of these representations an alternative remedy was implemented.

7.5 In respect of the divestment processes, we received feedback from several stakeholders that the actions of CC staff were transparent and stakeholders welcomed the consistency and availability of the CC team. The BAA investigation lasted for a long period, partly due to the complexities of the divestments and also from the legal challenges made. Throughout this period the team remained active. Grant Thornton told us that this provided continuity and familiarity with the case, an absence of conflicts and flexibility to convene at relatively short notice to make decisions. Other stakeholders also welcomed this.

Investigation procedures

Heathrow's views

7.6 Heathrow acknowledged that overall the CC process was transparent. However, Heathrow made an observation that in its opinion there was no clear evidence to demonstrate the causal link between the issue and the divestment remedies applied. It also commented on the conduct of the CC panel in the context of the importance of maintaining professional working relationships. It said the maintenance of professional working relationships would help to ensure that decision-making was not negatively impacted.

Interaction with the CC's review of the CAA's regulatory price determination

7.7 In October 2007 the CC's report and recommendations on charges at Heathrow and Gatwick for the five years from 1 April 2008 (the Q5 period)[144]

---

[144] Q5 was the fifth quinquennial price control period set by the CAA as the economic regulator for the UK aviation sector. It covered the five year period from March 2008 to March 2013 and was extended by one year to help manage the risk associated with the transition between the Airports Act and the CAA12. See CAA announcement, March 2011. Hence there was a timing overlap between the price review and the CC market investigation.

was published.[145] The former director of BAA who oversaw BAA's input into the investigation process commented that CC panel members for the market investigation were also involved in the CC's review of the Q5 regulatory price determination by the CC. This individual noted that whilst this approach might have brought benefits from sector expertise, it also ran the risk of merging the issues from the two inquiries together, which could have adversely affected the outcome from the price control process from the company's perspective.

CMA's view

7.8 These points are important observations regarding inquiry procedures and the views expressed by these stakeholders reiterate the importance placed on maintaining the fairness of investigation processes and policies.

7.9 In considering these points we note that:

(a) The CAT considered the CC's approach to the investigation and BAA's legal challenges were unsuccessful, including those based on apparent bias.

(b) In 2010 the Chairman of the CC asked an independent panel to examine the CC's rules and practices in relation to possible conflicts of interest of its members.[146] While the CC made a conscious decision regarding membership of the inquiry groups for the Q5 price review and 2009 investigation, the independent review subsequently affirmed that, in its view, a member should not be disbarred from serving on a new investigation on the grounds of having prejudged the issues solely because he or she has been a chair or member of a previous investigation in the same sector.

(c) The CMA has a clear governance framework in place to manage risks of bias and conflict. These policies and procedures are followed at the launch of every project and updated as necessary through the life of the project.[147,148] The policy categorises the most common interests that could put the CMA's impartiality at risk as: financial interests, organisational relationships, personal relationships and

---

[145] CC announcement 3 October 2007. The members of the inquiry group for the CC's review were Christopher Clarke (Group Chairman and CC Deputy Chairman), Laura Carstensen, Dr John Collings, Professor Jonathan Haskel, Richard Holroyd, Professor Peter Moizer and Professor Sudi Sudarsanam. For details of the members of the inquiry group for the 2009 investigation see Appendix 2, paragraph 2.
[146] *Review of the Competition Commission's policy on conflict of interest*, October 2010.
[147] See CMA Board Rules of Proceedure.
[148] CMA Annual Report 2014/15, page 75.

prejudgement.[149,150] This policy addresses these risks and ensures that a CMA panel member or member of staff remains able throughout the case to address matters under their consideration impartially.

7.10 The CMA expects its board and panel members to behave in accordance with the Principles of Public Life and its staff to follow the Civil Service Code, both of which include the following values: integrity, honesty, objectivity and impartiality. These expectations are communicated widely and systematically within the CMA and set out for panel members in the panel code of conduct.[151] The CMA's guidelines provide that if at any time during an investigation it appears to the chairman that, because of a particular interest of a member, it is inappropriate for him or her to remain in the inquiry group, the chairman may appoint a replacement.[152]

Implementation of the divestments and divestment sequencing

7.11 The CC originally required the divestments of the three airports to be completed within two years of issuing its March 2009 final report into the market investigation.[153] This timetable changed due to the legal challenges made by BAA and the subsequent MCC review undertaken by the CC in 2011. BAA's legal challenges also led the CC to change the sequencing of the divestments. Originally the order of divestment envisaged was consistent with the size of the airports – Gatwick's sale would be followed by Stansted and then the Scottish Airport.[154] Because BAA continued to challenge the sale of Stansted, the CC changed the order of divestments so that Edinburgh was sold before Stansted.[155]

7.12 BAA initiated the sale of Gatwick in advance of the CC's final report. Gatwick was sold to GIP in December 2009. This sale process lasted for 13 months. This was relatively long (relative to, for example that which would normally be expected in a merger inquiry), but completed at a time acceptable to the CC given the early initiation of the sale process. A period of inactivity existed when BAA rejected the initial bids made for Gatwick in May 2009 (with the intention of selling in June 2009) because these did not meet its valuation. Grant Thornton told us that this time provided for the sale allowed BAA to

---

[149] See market investigation guidelines: CC3, p15, FN33.
[150] CMA members and staff are required to approach decision making with an open mind. This consideration would be relevant both at the outset of an investigation and during the course of the investigation while evidence is still being gathered and evaluated.
[151] See Code of conduct for CMA panel members.
[152] See market investigation guidelines: CC3, p15, as provided for in the Competition Act 1998.
[153] The deadlines set by the CC for individual airports were not made public in the final report, in line with normal practice.
[154] The CC's remedy left open the option for BAA to choose to divest either Edinburgh or Glasgow.
[155] See CC press release.

negotiate an improved price for Gatwick, helped by BAA's decision to commence the sale process before the CC had accepted final undertakings.

7.13 BAA completed the divestment of Edinburgh to GIP in May 2012. This sale process took six months, compared with the nine-month period the CC had allowed.

7.14 The divestment of Stansted and sale to MAG was completed in February 2013, with this sale process lasting seven months which was in line with the CC's requirements. This third divestment completed the implementation of the undertakings and therefore the CC released Heathrow Airport Holdings (formerly known as BAA) from the undertakings in March 2013, following a consultation.

Stakeholders' views

General comments

7.15 Those involved in bidding for an airport, including both successful and unsuccessful bidders, said that the CC had used a workable timetable for evaluating the suitability of bidders and the completion of the divestments. MAG said that the timetable had allowed it sufficient time to prepare a credible bid for Stansted. The DfT said that overall the CC market investigation was seen to be fairly swift.

7.16 The former Ferrovial director[156] who oversaw BAA's divestments told us that after each divestiture the process by which the CC evaluated potential purchasers improved. The implementation of divestment remedies became smoother and more refined, both with regard to the timetable for evaluating potential purchasers and the basis on which potential bidders were evaluated. Having said this, Ferrovial retained a concern about how the CC's and the MT's involvement might have affected the competitive tension in the auction process. This point is considered further in our evaluation of the MT, later in this section.

Views relating to Gatwick

7.17 Several stakeholders noted the difficult economic conditions and poor availability of debt financing during the period 2008/09. Some suggested that this led to a low price being secured by BAA for the sale of Gatwick. As discussed in paragraph 6.9 Heathrow has estimated that impairment costs

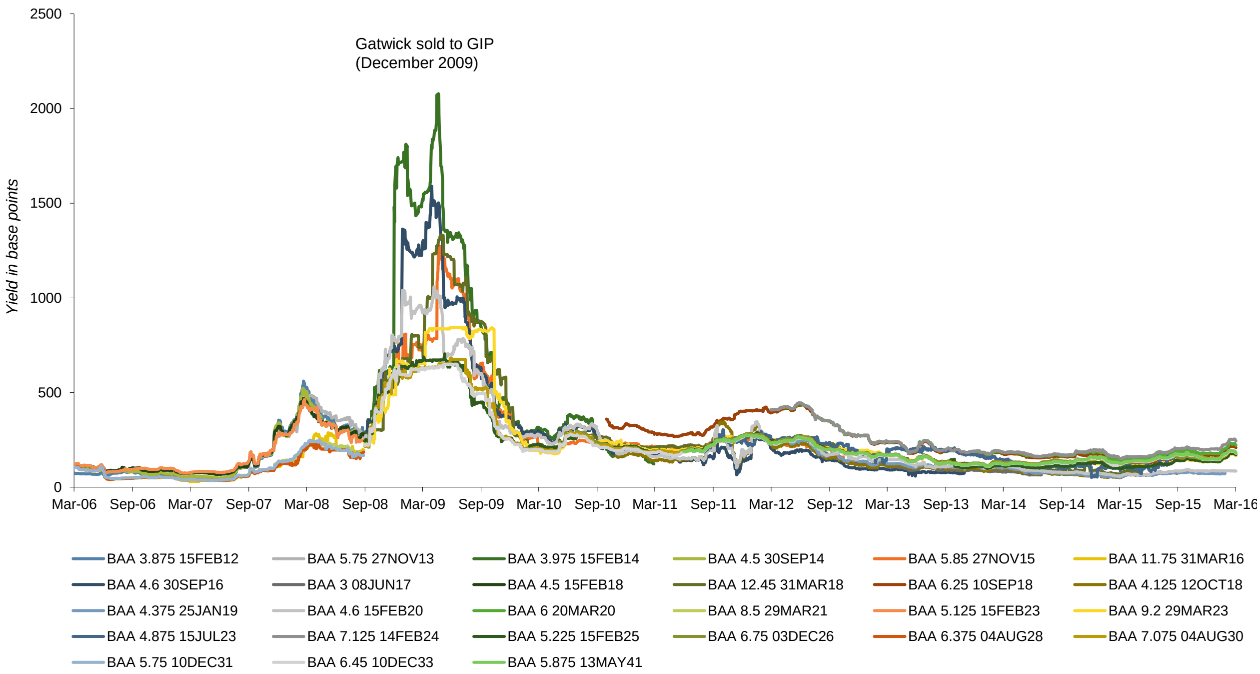
---

[156] BAA's parent company.

were £225 million, based on a comparison to the accounting book value of Gatwick at the time. Heathrow also said that the extraction of the equity value of the business had not been in the interest of customers, since no mechanism was established to return any benefits directly to customers. Heathrow thought that post-acquisition obligations should have been imposed on GIP.

7.18 A financial institution told us that the availability of debt financing at the time of the Gatwick sale was low in a historical context, and the cost of debt was high. This is illustrated by reference to the yields for BAA's debt, as shown in Figure 7.1.

Figure 7.1: BAA yield spreads 2006 to 2016



Source: Bloomberg and CMA annotations of airport divestment timing.

7.19 The figure shows the BBA bond trading yield on which BAA's bonds traded and shows that the risk perceived by bond investors dramatically increased during the period from late 2007 to the end of 2009. This period was affected by the global financial crisis and other uncertainties including a government review which at the time appeared to suggest airport assets might not be able to be used as security for debt investors.[157] The increased economic uncertainty and perceived increased risk that companies would not be able to finance their debt had two consequences. First, investors demanded higher

[157] See BAA Investor Report December 2009, p8.

interest rates than in the preceding period and second, it was harder for airport owners to raise new funding in that period.

7.20 GIP told us that Gatwick was sold by BAA at a valuation of approximately 0.85 times the RAB, which GIP saw as an attractive valuation. GIP said that due to the global financial crisis, bond market conditions were weak and its purchase of Gatwick was undertaken with lower than desirable debt funding. GIP told us that the consortium purchasing Gatwick funded the transaction with a debt level of 45% of RAB, lower than the typical 60 to 70% considered conservative for airport funding structures. GIP said that it had not been possible to raise more debt and Gatwick's shareholders had therefore invested a high level of cash as 'bridge equity'. By 2011 debt market conditions had improved and it was possible to refinance, raising additional debt and withdrawing bridge equity. GIP noted that characterising the refinancing as a 'dividend' was inaccurate and the withdrawal of equity should be seen in conjunction with the high levels of capital investment at Gatwick of around £1 billion in the first five years of ownership.

CMA's view

7.21 As discussed in Paragraph 6.34, under the CC remedy, the price paid for Gatwick was driven by the judgement of prospective new owners rather than the historic level of Gatwick's asset base as recorded in the regulatory accounts. In determining the valuation of Gatwick, prospective owners would have evaluated the future growth prospects of Gatwick under new management. The level of the asset base, although relevant to the valuation, would have been of secondary importance in light of the new commercial strategies and operating procedures new owners would employ. It is also possible that prospective owners may have considered that the existing asset base was too high, or not optimally configured for their purposes. Further, when divestments are sold at a potential premium value, there is not a process to recoup this. Evaluating a fair price is an inherently challenging exercise.

7.22 It is clear from the evidence above that conditions during the period 2008/09 may not have been supportive of peak valuations for airport assets. We do not agree, however, that an alternative valuation approach, such as one based on a multiple of the regulatory asset base in historic transactions, would have been merited. The CC's approach had several advantages:

(a) It sought to address the harm that had been identified from BAA's common ownership as quickly as practicable. Timely implementation is an important aspect of a remedy's effectiveness.

(b) It avoided speculation regarding the counterfactual price under different market conditions, or the formation of a possibly spurious forecast of where market prices might go in the future.

(c) It avoided prolonged uncertainty and potential under-investment for the airport affected, which would have been unlikely to be in passengers' interests.

(d) A competitive process involving those with a genuine interest in running Gatwick as a competitive airport set the price, and no account was taken of views of third parties which could have been motivated by different incentives. We consider that the price paid for Gatwick was the market valuation at the time of the sale. BAA had sufficient time to respond to initial bids to state that they did not meet its valuation and hence there was sufficient time in the divestment process for higher bids to be negotiated.

Divestment sequencing

7.23 Stakeholders endorsed the decision to allow a sequencing of the three divestments, rather than requiring all three to be sold at the same point in time. Gatwick was divested in 2009; Edinburgh in 2012 and Stansted in 2013.[158] Separate to the CC interventions, BAA/Heathrow has also chosen of its own volition to sell its other smaller regional airports since the conclusion of the market investigation – Southampton, Glasgow and Aberdeen. The flexibility shown by the CC to amend the sequencing of the Stansted and Scottish airport divestments in light of BAA's legal challenge was welcomed by BAA[159] at the time of this decision. Grant Thornton told us that the sequencing change made by the CC had allowed the divestiture process to run smoothly, reducing the likelihood of a divestiture trustee being appointed (see paragraphs 7.42 to 7.44).

Bidder evaluation criteria

7.24 The CC required BAA to sell each of the airports subject to divestment to one of the suitable bidders approved by the CC. The MT, whose role is discussed further below, supported the CC in this assessment. The airport sales were relatively large and complex divestments. The CC needed to be involved but not unnecessarily stifle the sale process. It was important to maintain a

[158] The CC originally required BAA to divest all three airports within two years of the publication of its final report in 2009. The later sale of Edinburgh and Stansted reflects delays resulting from litigation by BAA.
[159] BAA press release October 2011.

competitive auction process and ensure the successful purchaser would be credible. The bidders were required to demonstrate:

(a) **independence**: they were independent of BAA (and its owners at the time – ADI/Ferrovial);

(b) **expertise**: they could show an intention to provide appropriate expertise and financial resources to operate and develop the airports as effective competitors; and

(c) **absence of competition concerns**: clarify that if successful they would not create new or further competitive concerns.

7.25 In progressing this assessment of the suitability of bidders, some complications did arise. Examples were the consortium bids for Edinburgh and also GIP's ownership of London City and Gatwick when bidding for Edinburgh. In relation to MAG, issues arose regarding its ownership of Manchester and East Midlands when bidding for Stansted. East Midlands Airport competes with Stansted for freight/cargo operations. It was also necessary to determine if MAG was a public or private body, given its corporate structure is based on local authority ownership.

7.26 The CC also took steps to understand the competence and expertise of the bidders for operating and improving the airports. Under BAA, airports other than Heathrow had historically operated more as a 'division' than fully stand-alone airports. Hence the need for strengthened management and investment in IT was apparent.

7.27 Stakeholders told us that such complications were dealt with swiftly and transparently by the CC. Bidders were informed early in the process of any concerns and provided with an opportunity to address these. Resolution of any initial concerns then allowed the bidders to focus on their due diligence and commercial arrangements, rather than on being focused on prolonged dialogue with the CC.

7.28 MAG told us that it had been given the ability to focus on the commercial aspects of its bid for Stansted as the CC had provided prompt responses to potential blocks to MAG's interest in the purchase. Specifically, without the CC's prompt response to confirm it was an acceptable bidder, MAG told us that it would not have been able to secure the necessary equity injection it required to raise the funds needed for the acquisition of Stansted.

7.29 Bidders not only praised the promptness of feedback from the CC, but also the clarity and transparency on which specific aspects of their bids needed further attention or clarification.

7.30 Grant Thornton told us that it considered the CC's bidder evaluation criteria were appropriate and not too onerous. It noted, however, that the CC had needed to be mindful of any potential bias when assessing the expertise of bidders. There was a potential for this type of assessment to favour trade bidders, that is, those already operating airports, over financial bidders.[160] Grant Thornton said that while this had been a risk,[161] in practice it did not materialise as the CC had acted pragmatically in assessing expertise, noting that some bidders may not, for example, be in a position to clarify their intended management teams until their success in bidding was known.

Involvement of the monitoring trustee

Role of MT and stakeholders' views on its functioning

7.31 Grant Thornton was the MT for the BAA divestments.[162] BAA selected and appointed Grant Thornton. The CC approved the appointment of the MT for the Gatwick sale. Based on the MT's performance for this divestment, the CC endorsed re-appointment for the subsequent Edinburgh and Stansted sales.[163]

7.32 The MT's role involved reviewing due diligence material provided to bidders and facilitating/supervising bidders' presentations to the CC group. Selected bidders were reviewed by the MT using the CC's bidder evaluation criteria, discussed previously.

7.33 The MT also applied the financial resourcing criteria developed by the CC. This was necessary to ensure that the successful purchaser had access to sufficient financial resources to acquire, develop and operate the airport concerned. Resourcing considerations were not just restricted to bidders' ability to finance the acquisition price. The MT also reviewed the bidder's

---

[160] We note that judgement will be required in situations where there may be a trade-off between the number of bidders which would enable the vendor to run as competitive a sales process as possible and the number of bids which meet the required level of management expertise.

[161] We note that in assessing the relative merits of trade buyers versus financial bidders it is possible that financial bidders may seek to form partnerships with existing operators of airports to satisfy part of the evaluation criteria. An infrastructure investor interviewed during our evaluation mentioned there are examples of these relationships not working well in other countries because shareholders and traditional airport operators tend not to have the same long-term investment horizon or face the same alignment as the infrastructure investors that often represent the largest shareholder(s).

[162] Grant Thornton commenced work for the Gatwick sale that was initiated by BAA in advance of the CC remedy being formalised. At this point Grant Thornton was referred to as a shadow monitoring trustee. Once the undertaking was in place, it became the MT in a formal capacity.

[163] The CC also appointed Burges Salmon and Evercore as legal and financial advisers respectively for the divestiture process. The roles of these advisers were less extensive than the MT and overseen by the CC. We therefore did not seek direct feedback from these organisations. Former CC staff members interviewed during the evaluation noted the legal and financial work undertaken was important to ensuring the divestment process worked well.

intended financial strategy including refinancing options, dividend forecasts and exit strategies. This was because the financial strategy might also have potentially affected a purchaser's ability to operate or compete effectively.

7.34 Bidders were required to provide evidence that they had robust long-term financial resources and sufficient headroom in financing facilities or capacity to deal with significant adverse conditions. To assess this, stress testing was undertaken using scenarios such as recession, extreme weather and, for the Edinburgh and Stansted sales, volcanic ash.[164] Bidders were able to respond to any concerns regarding the outcomes of stress testing with their proposed mitigating actions. Bidders whose initial financial proposals raised concerns were not immediately dismissed as being an unsuitable bidder. Instead an opportunity was presented to revise financing proposals. This was welcomed by both successful and unsuccessful bidders.

7.35 The CC also worked with the MT to ensure that the bidders could demonstrate an ability to access financial resources needed to develop and create new major runway capacity, if and when required. In considering this issue, the CC had regard to the potential for passenger numbers to grow as the airports improved. It also had regard to the impact of government policy on the airport's prospects for expansion. Stakeholders such as GIP, which was successful in purchasing Gatwick and Edinburgh, have commented that this foresight has proved to be a significantly important consideration.

7.36 The MT performed two further functions. It operated a preservation function to ensure that the assets were maintained prior to sale. It also operated a separation function to ensure BAA was on track with its preparations for separation, principally IT separation, so that this did not hinder the sale process and timetable. Grant Thornton told us that BAA had successfully delivered the IT separation required and had been ready for handover at the point of completion with only small areas of agreed legacy arrangements remaining.

7.37 The appointment of an MT was supported by stakeholders. Whilst the CC may have been able to resource some aspects of this function internally, the decision to appoint an independent suitably qualified body to oversee the complexities of the divestment process of three significant assets was welcomed.

7.38 It has been suggested by an individual involved in supporting BAA's sale process that the MT's involvement had increased the required level of

---

[164] The volcanic ash cloud that resulted from the eruption of Iceland's Eyjafjallajökull volcano in 2010 led to the closure of several UK airports.

information that bidders had needed to provide. However, a successful bidder said that the information burden had not been onerous and that CC involvement had actually aided the sale process due to the desire for maximum transparency and also because of the active involvement of the MT. The same individual was complimentary about how the MT had acted pragmatically and allowed BAA to lead the sale process.

7.39 Many stakeholders commented on the MT's professionalism and the effective working relationships established and maintained with all relevant parties. The clarity of the MT's process and promptness in dealing with issues was also welcomed. Grant Thornton said that both the CC and BAA had acted professionally throughout the divestment process. All parties had been transparent and had acted swiftly so as to avoid delays. Good working-level relations had been formed. All parties had worked hard to ensure the complex and large sale process were completed smoothly.

Extent of involvement of CC

7.40 The ex-Ferrovial director overseeing the divestments told us that initially in the process there had been some ambiguity and therefore uncertainty whether the CC would seek to approve or even identify the preferred bidder for the Gatwick sale. BAA made representations that this was not necessary given that all bidders had been assessed as meeting the required competence as set out in the CC's bidder evaluation criteria. This issue was further complicated by the CC's consultation on the purchase undertakings that followed BAA's announcement of the sale of Gatwick. BAA was concerned with the timing of this, given its potential to complicate an agreed, publicised sale transaction. In reality no such complications actually arose, but the potential for this was raised as a concern. The CC clarified it would not seek to identify its preferred purchaser, it was focused instead on ensuring prospective bidders met the bidder evaluation criteria.

7.41 In this investigation the CC did not intervene in the choice of purchaser at Gatwick. In the subsequent sales for Edinburgh and Stansted the issue was not relevant as by then the CC had clarified it would not intervene in choosing the successful bidder.

Potential appointment of divestiture trustee

7.42 The CC's divestment remedy provided for the appointment of a divestiture trustee (DT) if BAA had not completed the divestments by the time period specified by the CC.

7.43 We received feedback from a former Ferrovial director that the MT's presence and potential for a DT to be appointed had impacted negotiation dynamics. It was noted that some bidders may prefer to deal with a DT appointed by the CC rather than the MT. This was because a DT's remit prioritised the timing of asset sales rather than the sale price. This individual said that there could be an incentive for bidders to push for sale by a DT because the DT's fiduciary duty differed from the incentive of the selling company to maximise disposal proceeds. Bidders might have thought this was an opportunity to acquire the asset at a lower price.

7.44 Grant Thornton told us that it considered the threat of a DT could focus the sale process, encouraging it to run to time. In this case, the prospect of a DT was not a significant factor as BAA progressed quickly with its sales processes and there had been no sense that serious bidders would delay and take the risk that a competitor would enter the process and secure a deal with a DT. Grant Thornton also commented that the CC timetable had been adjusted sensibly in light of BAA's legal challenges, so that the threat of a DT never became a likely factor driving the process.

Conclusions on the CC's remedies process and lessons learnt

7.45 In addition to assessing the impact of the remedies, our evaluation gathered views on the remedies process and considered whether lessons can be learnt from the CC's design and implementation of remedies.

7.46 Our evaluation has identified a number of lessons learnt regarding the remedies process.

(a) Even in contested decisions, it is extremely important to establish and maintain professional, constructive working relationships between the competition agency and the party implementing the sale of assets required by a divestment remedy. This enables both sides to achieve their objectives from divestiture.

(b) There are benefits to be gained from taking a flexible approach to the implementation of divestiture remedies (for example in relation to sequencing of transactions) where this can be achieved without compromising effectiveness.

(c) Involvement of an MT in a divestment remedy can add value to the divestiture process, beyond simple monitoring. This is particularly the case in complex divestments that require significant preparations to create separate stand-alone business entities. Ultimately an effective MT

can help the vendor achieve value for its divested assets and meet the timescales required by the competition agency.

(d) Making every effort to resolve any uncertainties and promptly clarify issues is of benefit to the remedies process. Issues may arise in areas such as:

(i) The roles of the parties involved, including the CC, MT, vendor and other professional advisers

(ii) Application of the criteria by which bidders are to be evaluated at approval stage and selection stage, if applicable.

(e) It is important to learn from experience gained during the remedies implementation process where such opportunities arise. This can include where there is a series of implementing similar remedies, such as a sequence of divestments of similar assets.

7.47 All stakeholders providing views were complimentary about the transparency of the remedies process. All parties involved in the divestments, including unsuccessful bidders welcomed the clear guidelines, timetable and consultative nature of the CC's approach. Stakeholders said they understood the CC process and had appropriate opportunities to influence this.

7.48 Stakeholders generally considered that the divestment timetable set by the CC was workable and that disposals were completed relatively swiftly given BAA's legal challenges, the large, complex assets involved and the need to judge consortium bids. The adaptability of the CC to the sequencing of the divestment remedies, whereby the order of divestments of Stansted and either Glasgow or Edinburgh was changed, was also seen as positive.

7.49 The CC worked alongside an MT, Grant Thornton, to assess the credibility of bidders in terms of financial resources, management expertise and independence. This was recognised as having been important to ensure the successful bidder would be in a position to operate the acquired airport successfully. The CC and the MT also made strenuous efforts to ensure the CC's involvement in no way stifled BAA's sale process and that a competitive auction process for each of the three assets was achieved. All stakeholders interviewed thought that the three main parties in the process – BAA, Grant Thornton and the CC – worked well together in a professional manner to implement the divestments and achieved a successful, smooth and appropriately paced divestment process.

Appendix 1: List of stakeholders

Stakeholder	Notes
Airports	
Heathrow	Heathrow Airport Holdings Ltd, previously BAA Ltd
Gatwick	Sold by BAA to GIP in December 2009
Stansted	Sold by BAA to MAG in February 2013
Edinburgh	Sold by BAA to GIP in May 2012
Glasgow International	Sold by BAA to AGS in December 2014, not part of CC remedy.
Aberdeen	Subject to behavioural remedy. Sold by BAA, but this sale was not part of the CC remedy.
London Luton	
Birmingham	
Airlines	
Ryanair	Scheduled passenger airline
IAG (BA & Aer Lingus)	Scheduled passenger airlines
Virgin Atlantic	Scheduled passenger airline
easyJet	Scheduled passenger airline
A cargo operator	Cargo/freight operator
Flybe	Scheduled passenger airline
Aer Lingus	Now part of IAG
Monarch	Scheduled passenger airline
Investors/airport owners	
Manchester Airports Group (MAG)	Acquired Stansted from BAA (also owns Manchester, East Midlands and Bournemouth airports).
Global Infrastructure Partners (GIP)	Acquired Gatwick and Edinburgh from BAA (and recently sold London City Airport).
Macquarie Infrastructure and Real Asset Division (MIRA)	Owner (through AGS) of Glasgow, Aberdeen and Southampton. Bidder in BAA divestment process.
Government	
DfT	
CAA	
Transport Scotland	

Stakeholder	Notes
Advisers and industry stakeholders	
Airports Council International (ACI)	Airport trade association
IATA	Airline trade association
Munrad Qureshi	Former London Assembly Member
Several financial institutions	Assisted BAA with sales process
Grant Thornton	Acted as Monitoring Trustee (MT)

Supporting notes

1. The Airports Commission has now completed its work and has been disbanded. Hence the CMA did not engage directly with the Airports Commission.

2. The CMA also interviewed staff who had worked on the inquiry team at the CC, some of whom are with the CMA now. The two Chairs of the panel of CC members who conducted the investigation were contacted but did not participate.

3. In visiting the various stakeholders, a number of ex-members of BAA and Ferrovial staff who are now working for other organisations offered their individual perspective to the CMA.

Appendix 2: The CC's 2009 market investigation

The Reference

1. The CC published its report on the supply of airport services by BAA in the UK on 19 March 2009. This followed a reference from the OFT on 29 March 2007. The OFT's reference under the Enterprise Act 2002[1] required the CC to investigate the effects of features of the market or markets for airport services in the UK such as exist in connection with the supply of airport services by BAA and whether such features prevented, restricted or distorted competition in the UK.[2]

2. The market investigation was conducted by a panel of CC members. The members of the Airports inquiry group were Christopher Clarke (Group Chairman and CC Deputy Chairman), Laura Carstensen, Dr John Collings, Professor Jonathan Haskel, Richard Holroyd and Professor Peter Moizer (until 3 March 2009).

3. As with all market investigations the CC defined a market to produce a framework within which to analyse the effects of market features. The CC considered that there was a bundled market for aeronautical services provided to airlines and their ground-handling agents, and that this was separate from the market or markets for commercial services at airports.[3]

4. In the terms of reference, airport services were defined to include:

   (a) the provision of airport infrastructure;

   (b) the coordination and control of the activities performed on or in airport infrastructure and the provision of associated services including security; and

   (c) the provision of associated commercial services (including catering, retail, car rental, sale of advertising space, car parking and activities relating to commercial property).

5. The CC defined (a) and (b) as aeronautical services and (c) as commercial services.

6. The CC had to consider a number of key questions during its investigation:

---

[1] Enterprise Act 2002.
[2] OFT (29 March 2007), Terms of Reference.
[3] CC (March 2009), BAA airports market investigation report, paragraph 2.41.

(a) Was there existing competition for both airlines and for passengers between the BAA airports and other airports?

(b) Was there scope for competition between BAA airports to develop?

(c) What were the existing constraints preventing the development of competition?

(d) Could any aspects of BAA's performance be attributed to a lack of competition to BAA from other non-BAA airports, or did these aspects of performance themselves adversely affect competition between airlines or other users of the airports?[4]

7. In answering these questions the CC looked at actual and potential airport competition; capacity and capacity constraints in relation to demand over time; the impact of planning and government policy; economic regulation; and the role of BAA including the implications of its ownership of seven airports.[5]

Assessment of competition in the supply of airport services by BAA

8. The CC noted the very substantial share of passengers using the BAA airports in the South-East and Scotland. However, to assess the effects of common ownership, the CC considered whether BAA's airports would compete under separate ownership. The CC assessed in turn:

(a) wider evidence on competition between airports and the circumstances in which it occurs;

(b) evidence on demand substitutability between BAA airports as a first indication of the scope for competition between them;

(c) capacity and capacity development: in particular, whether there was evidence on the extent to which capacity constraints may themselves result from the absence of competition between airports or other features such as the difficulty in obtaining planning permission, or government policy;

(d) the extent to which competition could be limited, particularly in the London area, by capacity constraints in the short or longer term; and

[4] BAA airports market investigation report, paragraph 2.
[5] BAA airports market investigation report, paragraph 1.

(e) regulation of the three designated BAA London airports (Heathrow, Gatwick and Stansted) – as a feature which in so far as regulation is intended to remedy the absence of competition may fail adequately to do so and give rise to an AEC between airlines – and, in addition, its interrelationship with the ownership of the airports.[6]

Conclusions on competition in the supply of airport services by BAA

Common ownership AEC

9. The CC concluded that BAA's common ownership of airports was a feature that prevented rivalry between airports which could potentially compete with one another. BAA's London airports (Heathrow, Gatwick and Stansted) were the largest airports that served London. Together they controlled 81% of London's runway capacity, approximately half of which was accounted for by Heathrow. The other half was shared nearly equally between Gatwick and Stansted.[7] Divestment of only one of Gatwick or Stansted would have left around 60% of London's runway capacity in BAA's hands. The CC decided to apply a divestiture remedy and in doing so, sought to address the AEC resulting from common ownership directly. In order to unleash[8] competition between Heathrow and Gatwick, Heathrow and Stansted and between Gatwick and Stansted the CC decided it was necessary to divest two airports to two separate owners.

Other AECs

10. Aside from BAA's common ownership of airports in south-east England and lowland Scotland,[9] the CC found that a number of other features of the relevant market gave rise to AECs. Specifically:

(a) Heathrow Airport's position as the only significant hub airport in the South-East;

(b) Aberdeen Airport's comparatively isolated geographical position;

(c) aspects of the planning system;

---

[6] BAA airports market investigation report, paragraph 4(e).
[7] BAA airports market investigation report, paragraph 10.37 and Table 5.1 based on the DfT's 2010 estimates of ATMs.
[8] BAA airports market investigation report, paragraph 10.61.
[9] BAA airports market investigation report, paragraph 1.

(d) aspects of government policy; and

(e) the regulatory system for airports at the time.[10]

11. The CC set out a number of remedies to address the AEC:

(a) Divestment of Stansted and Gatwick airports (to different purchasers).

(b) Divestment of either Edinburgh or Glasgow airport.

(c) Strengthening of consultation procedures and provisions on quality of service at Heathrow (meant as an interim measure until regulatory changes were put in place).

(d) Undertakings in relation to Aberdeen, requiring the reporting of relevant information (segmental analysis on costs, depreciating assets, revenue and profits in relation to aeronautical and non-aeronautical services) and consultation with stakeholders on capital expenditure.

(e) Recommendations to the Department for Transport (DfT) in relation to economic regulation of airports.

(f) Recommendations to the DfT on airport transport policy.

Heathrow's hub status

12. The CC found an AEC from Heathrow's position as the only significant hub airport in the South-East. However, the CC did not expect that Heathrow's hub status would change following the divestment of Gatwick and Stansted.

13. The CC suggested that in the absence of BAA's common ownership Heathrow would still have substantial market power as a result of several factors. These included the difficulty for airlines in switching services to other airports away from Heathrow; network effects; locational advantages;[11] extensive terminal and runway facilities (including two full-length runways) and the absence of these facilities at other airports in the South-East.[12] With regard to switching, the CC noted that the tight capacity situation in the London area in the years prior to the 2009 report had made it more difficult for airlines to switch between airports.[13]

[10] BAA airports market investigation report, paragraph 1.
[11] BAA airports market investigation report, paragraph 3.130.
[12] BAA airports market investigation report, paragraphs 5.7 & 5.8.
[13] BAA airports market investigation report, paragraph 5.9.

14. The CC recognised that Heathrow was likely to require continued price control for the foreseeable future in light of its substantial market power. Although the CC was of the view that Heathrow had market power[14] over and above what it acquired from BAA's common ownership and that it would retain this market power after separation,[15] the CC did note that airlines operating out of other airports competed with Heathrow for short-haul passengers. BAA confirmed that network airlines operating from Heathrow competed for short-haul passengers with low cost carriers (LCCs) operating from airports such as Stansted.

Events during and following the 2009 investigation

15. During the investigation BAA had announced the sale of Gatwick around September 2009. As this was ongoing and had not been completed by March 2009, the CC considered Gatwick under BAA's ownership during its investigation.

BAA's first appeal

16. BAA disputed the CC's decision and appealed to the Competition Appeal Tribunal (CAT) contending (i) the remedies were disproportionate and (ii) the CC's decision was affected by apparent bias.[16] The CAT dismissed the appeal on proportionality, but upheld BAA's appeal on apparent bias, which related to the appropriateness of a particular individual forming part of the CC Group responsible for the investigation and report, rather than to the appropriateness of its conclusions. The CC appealed to the Court of Appeal, which in October 2010 reversed the CAT's decision on apparent bias and restored the CC's original decision from its 2009 report.[17] BAA sought permission to appeal further to the Supreme Court, but this was refused in February 2011.

17. Due to the time that had passed since the report the CC decided to consider whether there had been a material change of circumstances (MCC) or other reasons which meant that it should not confirm the remedies relating to the divestment of Stansted and either Edinburgh or Glasgow airports. Having considered the arguments and evidence submitted, the CC decided there was no material change of circumstances or other special reason for considering

[14] This view on Heathrow's hub status was also confirmed in the CC's 2011 MCC report where it stated that there had been no significant change in Heathrow's position as a hub airport since 2009 and that the constraint on Stansted actually or potentially exerted had not reduced (Consideration of material change of circumstances report (19 July 2011), paragraph 232).
[15] BAA airports market investigation report, paragraph 5.38.
[16] Judgment of 21 December 2009 in *BAA Limited v CC* [2009] CAT 35.
[17] Judgment of 13 October 2010 in *BAA Limited* v *CC* [2010] EWCA Civ 1097.

that the remedies proposed in 2009 were no longer proportionate and appropriate, and in July 2011 confirmed its initial decision.[18] Further detail on the MCC consideration is included below.

Consideration of possible material changes of circumstances[19]

18. BAA completed the divestment of Gatwick in December 2009, prior to the MCC. Remedies other than the divestment of Stansted were not appealed by BAA and therefore were not considered by the CC.

19. BAA set out what it said were material changes of circumstances since the 2009 report, which, in its view meant that the CC should not require the divestment of Stansted.[20]

20. One of the factors BAA cited was a change in government policy regarding runway expansion. The coalition government in May 2010 changed the UK government's policy to one opposing the building of new runways in south-east England. As a result there was no immediate prospect of construction of a third runway at Heathrow, or of support being given for new runways at Gatwick or Stansted. This meant the potential benefits of competition in south-east England attributable to new runway capacity were likely to be delayed, and there was a reduced likelihood that any new runways would be built in south-east England in time to come into use within the next 30 years.[21]

21. The CC saw the change in government policy with respect to the building of new runways in the South-East of England as the only material change of circumstances suggested by BAA. The CC took into account this change but concluded that it did not alter the CC's findings. It concluded that it did not remove the scope and need for competition between airports in south-east England, and it remained necessary to remedy the AEC identified in its 2009 report.

22. The CC concluded that even if no new runways were built in south-east England, the requirement (over the long term) that BAA divest Stansted would still be justified and there were no material changes of circumstances or other

[18] Consideration of possible material changes of circumstances (19 July 2011).
[19] Consideration of possible material changes of circumstances (19 July 2011), according to which section 138(4) of the Enterprise Act 2002 requires the CC's decision under subsection (2) to be consistent with its decisions as included in its report by virtue of section 134(4) unless there has been a material change of circumstances since the preparation of the report or the Commission otherwise has a special reason for deciding differently.
[20] Other changes that the CC was not persuaded represented significant changes of circumstances included: the intensity of competition that had emerged between European airports to attract LCCs; Heathrow's position as the UK hub airport had strengthened; there had been a significant fall in the level of Stansted's profitability.
[21] The 2009 report also used 30 years as the appropriate period for assessment. Consideration of possible material changes of circumstances, paragraph 8.

special reason that led the CC to consider that the remedies proposed were no longer proportionate and appropriate.[22]

BAA's second appeal

23. In further litigation in September 2011 BAA appealed to the CAT against the CC's confirmation that after a consideration of a possible material change in circumstances it would require the company to sell both Stansted and Glasgow or Edinburgh airports.

24. In light of BAA's appeal the CC took the view that there was a real risk of delay arising and that given the fact that BAA was not challenging the Scottish airport sale, the CC decided that it would be in the interests of affected passengers and airlines to proceed with the sale of either Glasgow or Edinburgh airport first.[23]

25. In February 2012 the CAT decided to uphold the CC's decision to require BAA to sell Stansted Airport.[24,25]

Implementation of the CC's remedies

26. The remedies were implemented as follows:

(a) Gatwick and Edinburgh were sold to Global Infrastructure Partners (GIP) in December 2009 and June 2012[26] respectively.

(b) Stansted was sold to Manchester Airports Group (MAG) in February 2013.[27]

(c) The economic regulation of airports was changed with the passing of the Civil Aviation Act 2012 which received Royal assent on 19 December 2012.[28]

(d) Undertakings were accepted with respect to Aberdeen Airport in March 2011.[29]

(e) The CC made a recommendation to the CAA on consultation between Heathrow and its airlines until a new regulatory system was introduced.[30]

---

[22] Consideration of possible material changes of circumstances, paragraph 284.
[23] CC press release (7 October 2011).
[24] Judgment of 1 February 2012 in BAA Limited v CC [2012] CAT 3.
[25] BAA tried to appeal to the Supreme Court in February 2011 but this was refused
[26] Edinburgh Airport history, June 2012: GIP officially take ownership of Edinburgh Airport.
[27] Heathrow Airport, Annual Accounts.
[28] Civil Aviation Act 2012.
[29] Aberdeen Undertakings.
[30] BAA airports market investigation report, paragraph 2(c).

This remedy was concerned with the lack of responsiveness to airlines[31] (and passengers) on the part of BAA. The CC therefore suggested that the CAA, as airports' regulator, should take the lead in implementing the remedy to improve airline consultation, including specifically, the provision of appropriate information and process of consultation at Heathrow. This had the end aim of remedying detrimental effects related to lack of responsiveness to interests of users on capital expenditure which adversely affected the quantity, quality, location and timing of investment.[32]

27. The following section covers the remedies in more detail. It describes the way in which the CC expected the interventions to increase competition together with the nature and timing of anticipated benefits for consumers and other airport users.

Divestiture of both Stansted Airport and Gatwick Airport to different purchasers

28. The CC set out a number of benefits that might arise from separation of common ownership and increased competition. The CC's assessment reflected its view that the main benefit from the divestiture would result from the dynamic aspects of competition. As explained in Section 5 of the CC's report, competition in airport services is a dynamic process expected to drive prices and costs down, and increase innovation and productivity therefore increasing the quality and the diversity of choice available to customers. The CC stressed, however, that the precise outcome of competition was uncertain.

29. The CC also considered that there was scope for London airports to improve the way in which they deliver capacity in terms of timeliness, design and cost-effectiveness as well as its allocation to users. The CC considered that outcomes of competition over capacity development and allocation might not manifest themselves for several years but that the benefits to the process of capacity development and allocation would accrue much sooner as decisions began to reflect competitive pressures.[33]

[31] BAA airports market investigation report, paragraph 10.255.
[32] BAA airports market investigation report, paragraph 7.137.
[33] In *BAA Limited v Competition Commission*, the second appeal: BAA's view was that there was a Material Change of Circumstances, contrary to the finding of the MCC 2011 report. It argued that this justified departure from the 2009 remedies and appealed on four grounds. The CAT supported the CC's argument that an AEC did arise from common ownership and decided the CC was entitled to argue that constrained capacity benefits (ie benefits expected without additional runway in the South-East) as noted in the 2011 report were real and significant and outweighed the cost to BAA of divestment and therefore the divestment was proportionate.

30. The expected outcomes from the divestiture of Gatwick and Stansted to different owners can be categorised under the following areas which are considered in more detail below:

(a) service quality;

(b) innovation and/or efficiency;

(c) investment;

(d) route development/choice; and

(e) price/airport charges.

Service quality

31. CC decided that there would be competition for users by improving service quality at Gatwick and Stansted, as well as Heathrow, because separately owned airports would be more responsive to airline needs than BAA as a common owner.[34] The CC judged that service quality could often be a result of good management and organisation as opposed to large expenditure and that rivalry in the provision of service quality would supplement the effect of service quality rebate (SQR) targets.[35]

32. Heathrow was expected to seek to improve service quality (or restructure prices) so it could outperform its passenger number forecasts, and Heathrow's actions were expected to have a pro-competitive effect on the terms offered by Gatwick.[36]

Innovation and/or efficiency

33. The CC expected that there would be greater innovation and rivalry through dynamic competition which would increase the diversity of choices available and quality in order to attract consumers.[37] The CC was of the view that competition would essentially reveal opportunities to win business through superior and innovative design, lower costs, higher quality, greater flexibility and more efficient delivery of capacity.[38]

34. The CC also expected there would be scope for competition through adoption of differing commercial strategies between Heathrow, Gatwick and Stansted.

[34] BAA airports market investigation report, Appendix 5.1, paragraph 6.
[35] BAA airports market investigation report, Appendix 5.1, paragraph 19.
[36] BAA airports market investigation report, paragraph 10.57.
[37] BAA airports market investigation report, paragraphs 10.64 & 10.24.
[38] BAA airports market investigation report, paragraph 5.30.

In particular, these included focusing on specific types of traffic such as high-value users, airlines which convey higher numbers of passengers per air transport movements (ATM), or passengers that contribute disproportionately to retail revenues.[39]

35. Generally the CC considered that new management teams may find other ways to compete for valuable users. Generally these new management teams would use different management strategies and techniques that would arise through separate ownership and tend to increase innovation and efficiency.[40]

Investment

36. Overall the CC suggested that under separate ownership there would be competition from Gatwick that would have a positive influence on the design, cost, timing and allocation of new capacity which, at the time, was only being discussed at Heathrow and Stansted. Likewise, the CC expected that Stansted and perhaps even Heathrow would be more aggressive in approaching Gatwick's airlines to fill new capacity than they would under common ownership.[41] The CC suggested this would be the case in contrast to common ownership where capacity expansion at one BAA London airport would take away from (cannibalise) other airports and therefore reduce BAA's incentives to undertake and push forward with capacity expansions with strong incentive to win traffic from rival airports.[42]

37. Furthermore the CC suggested there would be an incentive to expand capacity and spend on productive capital. This view followed from the CC's substitutability analysis which indicated that initiatives at Heathrow such as capacity expansions and improvements in service quality would affect passenger numbers, airline performance and airport performance at Stansted. This was supported by BAA's own modelling at the time which demonstrated that passenger numbers and profitability at Stansted would be reduced by prospective capacity expansion at Heathrow. Heathrow would therefore expect to expand capacity and invest in order to win passenger numbers.[43]

38. The CC suggested the process of multiple bids and competition would also facilitate government decision-making in determining which capacity expansion proposals to support. Independent projects in terms of costs, efficiency, deliverability and impact on the environment could be considered

[39] Appendix 5.1, paragraphs 20 & 21. The CAA indicated to CC that volume of passengers was not the only area on which airports would compete – different passengers had different values according to what they spent in retail adding another dimension of competition.
[40] BAA airports market investigation report, paragraph 21.
[41] BAA airports market investigation report, paragraph 5.16(f).
[42] BAA airports market investigation report, paragraph 5.24.
[43] BAA airports market investigation report, paragraph 10.50.

rather than reliance on BAA (one organisation's) assessment of the impact of runway development.

39. In addition to better investment in new capacity the CC envisaged that there was scope for cost savings, particularly at Stansted.[44]

Price/airport charges

40. The CC stated that there was a possibility that Heathrow would offer lower passenger charges in order to increase volumes – this was expected as the profitability of Gatwick would no longer be factored into doing so.[45] Competition to increase passenger numbers was thought to be possible by rebalancing the landing and per-passenger charge. In relation to Heathrow and Gatwick, competition to fill off-peak slots was thought possible by rebalancing peak/off-peak landing charges or offering greater off-peak discounts to individual airlines.[46] It was also thought that targeted tariff discounts would be expected between Stansted and Heathrow in addition to airline specific improvements to quality in order to win passengers.[47]

41. The CC suggested that price competition would lead to higher capacity utilisation due to the degree of substitutability between Gatwick and both Stansted and Heathrow. Between Gatwick and Stansted this was expected to be modest at first. If this resulted in generous unpublished discounts this could then lead to lower average prices and higher capacity utilisation. However, the intensity of price competition would be reduced by capacity shortages.[48]

42. The CC noted that 'current capacity constraints would limit the intensity of price competition in the period following divestiture and that this implied that price control regulation in some form might need to continue at Gatwick and Stansted until the prospect of capacity expansion had an impact upon competition'[49]

[44] BAA airports market investigation report, paragraph 7.137*(a)*(vii).
[45] BAA airports market investigation report, paragraph 10.41(c).
[46] BAA airports market investigation report, Appendix 5.1, paragraph 6.
[47] BAA airports market investigation report, paragraph 10.41(d).
[48] BAA airports market investigation report, paragraph 10.41(b).
[49] BAA airports market investigation report, Appendix 10.1 paragraph 2.

Route development

43. The CC expected a higher degree of passenger substitution under separate ownership if this resulted in different marketing efforts, and/or an increase in the number of routes served.[50]

44. The CC suggested that over time there may be route development in terms of smaller aircraft being replaced by routes operated by larger aircraft and airlines deploying larger aircraft on existing routes. The CC suggested that the incentive to do this would depend on benefits obtained from passing lower passenger charges through to fares compared with costs of operating the larger aircraft necessary to accommodate larger passenger numbers per ATM.[51]

Timing of benefits expected

45. The CC envisaged that the timing of benefits would vary according to the specific benefit in question and whether capacity expansion was a relevant factor.

46. Quality and modest price benefits were expected by the CC in the period immediately following divestiture despite the persistence of capacity constraints and price control regulation. It was expected that during this period the divestitures of Gatwick and Stansted would enable the regulator to undertake comparative competition and in doing so improve regulatory settlements and spread best practice.[52]

47. It was also expected that the outcomes of competition over capacity development and allocation may not manifest themselves for several years but that the benefits to the process of capacity development and allocation would be expected much sooner as decisions would be more strongly influenced by competitive pressures.

48. The CC expected that users may experience pricing and quality benefits well in advance of capacity roll-out as airports, in anticipation of an increase in capacity, offered competitive contractual terms to attract new airlines or to prevent loss of incumbent airlines.

49. The benefits of divesture in the South-East were assessed by the CC in a qualitative way and there was no quantification for the region as a whole. Benefits from the divesture of Stansted were considered separately and

---

[50] BAA airports market investigation report, paragraph 3.28.
[51] BAA airports market investigation report, Appendix 5.1, paragraph 16.
[52] BAA airports market investigation report, paragraph 10.66.

encompassed potential savings on capital expenditure and operating expenditure relating to relative pay costs and reducing absenteeism.[53]

Divestiture in Scotland

50. The CC decided that the divestiture of either Edinburgh or Glasgow was required to effectively remedy the AEC arising from BAA's common ownership of the airports. The CC concluded that these airports were the closest demand substitutes for one another and passengers were relatively insensitive to changes in fares. There were also no sufficient external constraints that could impact on the potential for competition.[54]

51. The CC considered that competition would be expected from the divestiture of either Edinburgh or Glasgow. Based on assumptions[55] the CC expected discounts on existing services at Edinburgh to increase to the level already present at Glasgow, generating a present value of benefits to customers of at least £40 million. In addition to that, the CC expected further benefits from the competitive interaction between the two airports; from new services being initiated at both airports; and in the longer term from capacity developments and service levels at both airports being more closely aligned with customer interests.[56]

52. The CC indicated that the divesture of Glasgow or Edinburgh could be expected to result in benefits to customers within a relatively short period.[57]

Aberdeen's undertakings

53. The CC considered that Aberdeen had characteristics of a natural monopoly due to its comparatively isolated location. The CC also found evidence of a

---

[53] BAA airports market investigation report, paragraph 10.110.

[54] The CC's analysis indicated that 49% of Edinburgh's passengers would consider Glasgow their next best choice if no flights were available from Edinburgh, and Edinburgh's passengers were insensitive to changes in fares. Airlines accounting for the majority of passenger traffic at the two airports indicated to the CC that the two could be considered substitutable; there was little evidence of other neighbouring airports being good substitutes for Edinburgh's existing passengers and little evidence of airline switching involving Edinburgh in contrast to competing non-BAA airports. The ORC passenger survey indicated that 28% of Glasgow's passengers considered Edinburgh their second choice if no flights were available from Glasgow, compared with 17% for Prestwick. Glasgow passengers were insensitive to changes in fares; airlines accounting for the majority of passenger traffic at the two airports indicated to the CC that the two could be considered to be substitutable and the CC found little evidence of neighbouring airports, other than Prestwick and Edinburgh, being good substitutes for Glasgow's existing passengers.

[55] Estimates of benefit based on relative price trends over the past 15 years (detailed analysis is in Appendix 10.4 to the BAA airports market investigation report).

[56] BAA airports market investigation report, paragraph 10.108.

[57] BAA airports market investigation report, paragraph 10.114.

lack of ambition in development through underinvestment, poor facilities and cash generated at Aberdeen being used elsewhere in the BAA group.[58]

54. The CCs analysis[59] indicated that Aberdeen's local market power was reflected in relatively high levels of prices and profitability and relatively low levels of investment. In order to remedy the AEC and detriments flowing from this the CC initially proposed in its provisional decision on remedies a price cap linked to capital expenditure to reduce charges to a more comparable level with other airports while providing incentives for new investment. This was not implemented over concerns regarding unintended consequences it may have on capital investment. The CC therefore recommended undertakings to increase scrutiny, transparency and provide safeguards to airlines and other stakeholders regarding consultation on capital investment plans.

55. The CC decided to require undertakings from Aberdeen covering two aspects as follows:

(a) A requirement to publish audited accounts and segmental analysis on a depreciated replacement cost basis for Aberdeen (for the last five years and independently audited) together with: segmental analysis of the value of tangible assets on a depreciated replacement cost basis split by major categories of aeronautical and non-aeronautical assets; segmental analysis of revenue, operating costs and profits for major categories of aeronautical and non-aeronautical services; depreciated replacement cost return on capital employed; and average annual yield for fixed-wing aircraft and rotary aircraft and average yield per airline.[60]

(b) A requirement to consult at least annually with airport users and other relevant stakeholders at Aberdeen regarding its prospective capital expenditure programme, involving the timely publication of information on the airport master plan, a summary forward programme of capital projects together with forecast costs and details of individual key projects to the airlines and other interested parties and the creation of a forum for the proposals to be discussed.[61]

Recommendations in relation to government policy

56. In 2003 the government published the Air Transport White Paper (the White Paper). The CC expressed views regarding the White Paper, not on the

[58] BAA airports market investigation report, paragraph 7.139(a).
[59] BAA airports market investigation report, Appendix 10.7, paragraphs 4–16.
[60] BAA airports market investigation report, paragraph 10.215(a).
[61] BAA airports market investigation report, paragraph 10.215(b).

merits of the recommendations therein but regarding the possible consequence of the White Paper on competition.[62]

57. The CC felt the White Paper could distort competition, in particular by indicating a preference for new runway capacity at Stansted or Heathrow and indicating a preference for Gatwick only if there was no alternative.[63] This raised the risk of further delay to needed capacity but also made it difficult for projects to obtain planning consent that had not been recommended explicitly and given explicit government support in the White Paper. In addition, although projects not receiving explicit support would be considered on their merits, the specificity adopted in the White Paper meant that those projects were unlikely to be in as strong a position as if they had explicit support in the White Paper.

58. The CC expressed a concern that the government White Paper may be out of step due to its high level of detail and specificity. The CC thought that as airports and airlines changed and developed this gap would be unavoidable. Furthermore there was the concern that by specifying the nature of services that certain airports should provide, the White Paper could restrict the ability of such airports to develop and respond flexibly to market developments.[64]

59. Lastly, the CC felt that the specific nature of the White Paper blurred the boundaries of responsibility between the government and the airport operator, particularly where the government had commented on the type of runway it supported.[65]

60. The CC was concerned that the White Paper had the potential to constrain the ability of airport operators to respond to changes in the market,[66] particularly in the South-East. The CC was keen to ensure that the right framework was in place to allow for the delivery of additional runway capacity in the South-East as soon as possible and in an economically efficient manner in order to provide the scope for sustainable competition in the long term.

61. The CC therefore made recommendations to the DfT that it should consider the impact of the White Paper on the aviation market in the South-East, in light of divestiture of Gatwick and Stansted in its development of the National

---

[62] BAA airports market investigation report, paragraph 4.76.
[63] BAA airports market investigation report, paragraph 4.76.
[64] Illustrated by the outcome of a recent application by Coventry Airport for the expansion of its passenger terminal. The airport's niche role for freight operations, as identified in the White Paper, was one of the reasons advanced by the planning inspector for recommending the rejection of the application.
[65] BAA airports market investigation report, p112, paragraph 4.76(c), ie parallel runways (including mix mode) or segregated parallel operations.
[66] BAA airports market investigation report, paragraph 10.370.

Policy Statement on airports. Furthermore, the CC recommended that the National Policy Statement on airports should not constrain this market.

62. In developing the National Policy Statement on airports the CC considered that the DfT should give due consideration to the ambitions of the new owner of Gatwick, including the possibility of a second runway at Gatwick after 2019. Such a possibility had initially been sidelined by the White Paper as it initially only indicated such a preference in the event of there being no alternative.

Regulation

63. This section provides an overview of the CC remedies in relation to regulation, giving a summary of areas of concern regarding the economic regulation and a summary of the recommendations put forward to rectify these problems. The CC concluded in its report that the system of regulation of airports was a feature that distorted competition between airports by adversely affecting the level, specification and timing of investment and the appropriate level and quality of service to passengers and airlines.

64. The CC was concerned with a number of aspects of the economic regulation of airports that were designated for price regulation:

(a) the lack of clear statutory duties;

(b) absence of an economic licence;

(c) no requirement to ring-fence from default;

(d) no annual review of capex; and

(e) limited ability of the regulator to act between five-year reviews.

65. The CC's recommendations, which are considered in more detail below included the following:

(a) There should be an ancillary duty on the CAA of a procedural nature to consult and have regard to the views of airlines, allied with, but subsidiary to, the primary objective to promote the consumer interest through competition, providing the link between interests of airlines and consumers.

(b) Agreement with the DfT's proposal that the primary objective of the CAA should be to: 'promote the interests of existing and future consumers, of

passengers and freight services at UK airports, whenever appropriate by promoting effective competition.'[67]

(c) The regulator should be specifically required to take account of airline views through an ancillary duty: 'in discharging the primary objective it shall be the duty of the regulator to consult and pay due regard to the views of airlines.'

(d) In addition the regulator should consult designated passenger groups and airport operators.

(e) Support for the DfT's proposal of secondary regulatory obligations to:

(i) have regard to better regulation principles;

(ii) ensure reasonable demands for services are met; and

(iii) ensure licence holders can finance their licence obligations.

66. Under separate ownership of the three regulated airports the CC envisaged that, even where airports remained subject to price controls, the divestment would enable the CAA to collect three sets of accounts produced by independent operators, allowing it to benchmark their performance through comparative competition. The CC expected that under the enhanced regulatory regime in line with that proposed by the DfT this could enable the regulator to reduce regulatory costs through a reduction in the required level of scrutiny by the regulator and an increase in the likelihood that an appropriate regulatory settlement would be made. It was also envisaged that divestment would allow an improvement in service quality outcomes and operating expenditure and capital expenditure efficiency.[68]

67. The next section considers each recommendation above and specific concerns it attempted to address.

Movement to a flexible licensing regime and the suggestion of content for licences at Gatwick, Heathrow and Stansted

68. The CC envisaged a licensing regime (favoured by the DfT) with different licence obligations for airports of different sizes and [with different levels of] market power so that intensity of regulatory scrutiny could be relaxed or

---

[67] BAA airports market investigation report, paragraph 10.276(b).
[68] See the BAA airports market investigation report, paragraphs 6.64 & 6.65 for additional explanation of rationale.

intensified where there were opportunities to increase competition or where risk from market power was identified.[69]

69. Under section 40 of the Airports Act 1986, price caps,[70] were set by the CAA[71] and there were mandatory five-year price caps. Under Section 37 of the Airports Act 1986[72] airports with a turnover exceeding £1 million in two of the last three years were subject to economic regulation by the CAA. The Civil Aviation Act 2012 introduced a licensing regime under Part 1.[73] The introduction of Section 6[74] of the Civil Aviation Act 2012 put in place the market power test where airports require an economic licence from the CAA if the MPD test is met. It also allows varying of licensing conditions based on the circumstances of the airport. Both these aspects were supported by the CC and recommended during the CC's initial investigation.

70. In relation to Heathrow the CC made observations on the content for a licence. It suggested obligations relating to quality of service, prices, provision of information and annual and long-term plans.

71. In relation to Gatwick and Stansted, the CC suggested that should regulation of Gatwick and Stansted persist under separate ownership, it may well be appropriate in due course to use an alternative to the current RAB-based methodology.[75]

Change of the regulator's objectives and a focus on passengers

72. Concern was expressed[76] by the CC regarding the way the CAA performed its role as economic regulator of airports when interpreting its statutory objectives under section 39(2) of the Airports Act 1986.[77] Specifically the CC felt that in setting price controls the CAA had been putting too much emphasis on its fourth objective, to impose minimum restrictions.

---

[69] BAA airports market investigation report, paragraph 10.277.
[70] Extendable by 12 months
[71] The Secretary of State set the first price caps for Heathrow, Stansted and Gatwick.
[72] Airports Act 1986, section 37.
[73] Civil Aviation Act 2012, Part 1.
[74] Civil Aviation Act 2012, section 6.
[75] BAA airports market investigation report, paragraph 10.339.
[76] BAA airports market investigation report, paragraph 10.299.
[77] Section 39 (2) required the CAA to perform its functions under those sections in a manner which it considered was best calculated—(a) To further the reasonable interests of users of airports within the United Kingdom; (b) To promote the efficient, economic and profitable operation of such airports; (c) To encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports; and (d) To impose the minimum restrictions that are consistent with the performance by the CAA of its functions under those sections; (section 82 – 'user', in relation to an airport, meant – a person for whom any services or facilities falling within the definition of 'relevant activities' in section 36(1) are provided at the airport, or (b) a person using any of the air transport services operating from the airport). It was the final objective (d) on which the CC thought the CAA had placed too much emphasis.

73. It was also noted that there was insufficient weight given to the views of airline users. The CC therefore recommended: 'an ancillary duty of a procedural nature to consult and to have regard to the views of airlines, allied with but subsidiary to, the primary objective to promote the consumer interest through competition'.[78]

74. Furthermore, the CC thought the regulator should consult designated passenger groups and airport operators.[79] In addition, a range of other secondary regulatory obligations including ensuring that reasonable demands for services were met and that licence holders could finance their licence obligations were put forward.[80]

75. The CC did mention that in some circumstances airlines' interests are likely to diverge from those of final consumers and that there may be good reason for the regulator not to accept airlines' arguments on certain issues. The Civil Aviation Act 2012 follows many of the recommendations with its focus on 'users', where users are defined in a way that focuses on passengers.[81]

Suggested change to the appeals process

76. The DfT proposed airport licensing, which was supported by the CC. This meant that price controls and service standards would be imposed on airports through modification to their licences.

77. The CC recommended that appeals should be made to the CC on their merits and that they should take place after the regulator had taken its final decision. This aimed to replace the old Airports Act 1986 regime where, unless the Secretary of State directed otherwise, all price controls had to be referred to the CC for review under section 40(9) of the Airports Act 1986 before a final decision was made.[82] Furthermore, under the Airports Act 1986 judicial review was the only way to challenge the Secretary of State's decision regarding which airports should be designated for price cap regulation and the CAA's decision on price cap and service quality metrics.

78. The CC recommended that:

---

[78] BAA airports market investigation report, paragraph 10.299.
[79] BAA airports market investigation report, paragraph 10.299.
[80] BAA airports market investigation report, paragraph 10.301.
[81] The Civil Aviation Act 2012, section 1(1) and section 69 (1).
[82] The CAA had to 'have regard to' the CC's recommendations under section 46.

(a) an appeal should be to the CC, and the relevant party (airport, individual airlines and designated passenger groups) should have the right to appeal (symmetrical appeal);[83]

(b) the CAA should have information-gathering powers,[84] and powers to impose penalties as part of its new role;[85] and

(c) the CC included a number of other recommendations regarding appeals against price control and service quality licence modifications.[86]

Many of these aspects were introduced by the Civil Aviation Act 2012 and accorded with the CC's recommendations.[87]

Ring-fencing provisions in event of financial default

79. The CC recommended ring-fencing and administrative provisions to allow for providers of key services to airports to continue supply in the event a BAA airport or holding company was in financial default.[88] Such provisions are now included in the CAA12.

---

[83] BAA airports market investigation report, paragraph 35(b).
[84] BAA airports market investigation report, paragraph 10.301.
[85] Civil Aviation Act 2012, sections 50, 51 & 52.
[86] BAA airports market investigation report, paragraph 10.330. These included: an appeal should lie to the CC – but with no recommendation whether an investigative or adjudicative approach should be adopted; the appeal should be against the regulator's decision; the appeal should be against the merits of the regulator's decision; the rights of standing to appeal should lie in the relevant airport. In the individual airlines, and in designated passenger groups (and the DfT should therefore consider which groups to designate for this purpose); while there are issues to be resolved about the number of appeals and meritorious appeals, those matters should be controlled through the CC's power to regulate its own procedure rather than through limitation on standing to appeal.
[87] Under paragraph 1 of Schedule 1, sections 24 and 25, Schedule 3 and paragraph 1 of Schedule 5.
[88] BAA airports market investigation report, paragraph 10.361.

Appendix 3: Regulatory frameworks: a comparison between Airports Act 1986 and the Civil Aviation Act 2012

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
Regulator's objectives and duties	Section 39(2) imposed four objectives on the CAA in performing its functions as economic regulator of airports, namely: (i) To further the reasonable interests of users of airports within the UK, users was defined (section 82 of the Airports Act) as airlines, passengers and other users of air transport services at the airport. (ii) To promote the efficient, economic and profitable operation of such airports. (iii) To encourage investment in new facilities at airports in time to satisfy anticipated demands by the users of such airports. (iv) To impose the minimum restrictions that are consistent with the performance by the CAA of its functions under those sections.	Recommendation to create an ancillary duty of a procedural nature to consult and to have regard to the views of airlines, allied with, but subsidiary to, the primary objective to promote the consumer interest through competition, providing the explicit link between the interests of airlines and consumers sought by BA and other airlines (paragraph 10.299). The primary objective should be to promote the interests of existing and future consumers, of passenger and freight services at UK airports, wherever appropriate by promoting effective competition. In discharging the primary objective it shall be the duty of the regulator to consult and pay due regard to the views of airlines. The regulator should be also	Section 1: The CAA must carry out its functions in a manner which it considers will further the interests of users of airport transport services regarding the range, availability, continuity, cost and quality of airport operation services. The CAA must do so, where appropriate, by carrying out the functions in a manner which it considers will promote competition in the provision of airport operation services. In performing these duties the CAA must have regard to: *(a)* The need to secure that each holder of a licence is able to finance its provision of airport operation services in the area for which the licence is granted. *(b)* The need to secure that all reasonable demands for airport operation services are met.

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
	Section 36(1): ‘relevant activities’, in relation to an airport, meant the provision at the airport of any services or facilities for the purposes of— *(a)* the landing, parking or taking off of aircraft; *(b)* the servicing of aircraft (including the supply of fuel); or *(c)* the handling of passengers or their baggage or of cargo at all stages while on airport premises (including the transfer of passengers, their baggage or cargo to and from aircraft).	required to consult designated passenger groups and airport operators (paragraph 10.299). The CC also expressed concern with interpretation by the CAA of its four statutory objectives in setting price controls. It considered that the CAA was inclined to place particular emphasis on the fourth of its objectives, to impose minimum restrictions (paragraph10.301). Strong support for the DfT’s proposal that ‘there should be a number of secondary regulatory obligations, including obligations to have regard to Better Regulation principles, to ensure that reasonable demands for services are met, and that licence holders can finance their licence obligations’ (paragraph 10.301).	*(c)* The need to promote economy and efficiency on the part of each licence holder. *(d)* The need to secure that each licence holder is able to take reasonable measures to reduce, control or mitigate the adverse environmental effects of the airport to which the licence relates, facilities used or intended to be used in connection with that airport and aircraft using that airport. *(e)* Any guidance issued by the Secretary of State. *(f)* Any international obligation of the UK notified to the CAA by the Secretary of State. *(g)* Better Regulation Principles (section 1(4)). Section 69(1): ‘user’, in relation to an air transport service, means a person who— *(a)* is a passenger carried by the service, or *(b)* has a right in property carried by the service.

<table>
<tr><th></th><th>Airports Act 1986</th><th>Competition Commission
2009 Report</th><th>Civil Aviation Act 2012</th></tr>
<tr><td>Instrument of regulation</td><td>A permission to levy airport charges (section 38)</td><td rowspan="2">Full support for a licensing regime (of the kind favoured by the DfT in its consultation document published on 9 March 2009) with different licence obligations for airports of different sizes and market power (paragraph 10.277).

‘In particular, the operation of licensing regimes in other sectors demonstrates that under such a regime, regulators are able to relax the intensity of regulatory scrutiny, where they see opportunities for increased competition, or increase it, where they identify increased risks resulting from the exercise of market power.’ (paragraph 10.277)</td><td>A licence with conditions</td></tr>
<tr><td>Airports subject to economic regulation</td><td>The designation of airports for price control regulation by the Secretary of State.

‘One size fits all’/uniform approach to regulation.

Section 37: all airports at which annual turnover had exceeded £1 million in two of the last three years were subject to economic regulation by the CAA.</td><td>The CAA is empowered to carry out a market power test, as set out in the Act, to determine whether an airport operator should or should not be subject to economic regulation.

An airport operator that meets the following test requires a licence issued by the CAA:
Section 6: Market power test – three parts:
(a) The relevant operator has, or is likely to acquire, substantial market power in a market, either alone or taken with such other persons as the CAA considers appropriate.
(b) Competition law does not provide sufficient protection against the risk that the relevant operator may engage in conduct that amounts to an abuse of that substantial market power.
(c) For users of air transport services, the benefits of regulating the</td></tr>
</table>

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
			relevant operator by means of a licence are likely to outweigh the adverse effects.
Form of regulation	Designated airports (designated by the Secretary of State): *(a)* Mandatory five-year cap on airport charges after reference to the Competition Commission (sections 40(3) and 40(6)): • Can restrict increases in charges, or require reductions in charges and can allow different limits in different periods of time within the five year period. • Can be modified with the agreement of the airport operator. • Under section 40(7) the CAA had power to extend this period between price control modifications by up to a further 12 months. *(b)* Mandatory accounts conditions (section 40(2)).	See above: *Instrument of regulation/Airports subject to economic regulation*	A licence may include (section 18): *(a)* Conditions necessary or expedient having regard to the risk of abusive conduct by the licence holder. *(b)* Other conditions as the CAA considers necessary or expedient having regards to its statutory duties (section 1). A licence must include such price control conditions as the CAA considers necessary or expedient having regard to the risk of abusive conduct by the licence holder (section 19(2)).

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
	(c) Possibility of public interest conditions for operational activities following CC reference (section 46(2)). *(d)* Discretionary conduct conditions for 'relevant activities' (section 41(2)). Non-designated airports: *(a)* Discretionary accounts conditions (section 41(1)). *(b)* Discretionary conduct conditions for 'relevant activities' (section 41(2)).		
Flexibility	CAA able to advise Secretary of State on designation and de-designation of airports (section 37(5)). For example, CAA advised Secretary of State not to designate Luton (2000) and to de-designate Manchester and Stansted (2007). Secretary of State accepted advice on Luton and Manchester, but not on Stansted.	See above: *Instrument of regulation/Airports subject to economic regulation*	The CAA determines: *(a)* Which airports are subject to price control (after 'market power determination'). *(b)* Form of price control (eg price cap, commitments etc). *(c)* Duration of price control (section 19(7)). *(d)* Charges subject to price control – any charge for goods or services (section 19(6)) not just airport charges as in Airport Act 1986.

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
	A statutory period of five years between price control modifications (The CAA had powers under section 40(7) of the Act to extend this period between price control modifications by up to a further 12 months) and the CAA had no powers to modify the conditions during the five-year period for which they were set, except with the agreement of the airport operator concerned.		*(e)* Non-price control conditions (no longer subject to section 41 of the Airport Act 1986).
Enforcement	Powers to issue a compliance order on an airport operator that is not complying with a condition attached to a permission to levy airport charges. An order requires compliance with the condition and allows third parties to claim for any loss or damage sustained or injustice suffered (sections 48 and 49). The CAA can revoke the permission to levy airport charges of an airport operator that contravenes a compliance order (section 49).	The CAA should have information-gathering powers, and powers to impose penalties, commensurate with its new role (paragraph 10.301).	The CAA has powers to obtain information: The CAA may by notice require a person to provide— *(a)* information; or *(b)* a document that is in the person's custody or under the person's control (section 50). Powers to impose penalties for breach of a licence condition or breach of an enforcement order issued in relation to a licence condition (sections 39 and 40). Powers to impose penalties for non-compliance with information notices

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
			issued by the CAA and for destroying information or knowingly or recklessly supplying false or misleading information (sections 51 and 52).
Appeal system (against price control and service quality licence modifications)	Judicial review was the only way to challenge the Secretary of State's decision about which airports should be designated for price cap regulation and the CAA's decision on the price cap and service quality metrics that should apply. The CAA must refer all price controls to the CC for review (section 40(9); unless the Secretary of State directs otherwise), but the CAA must 'have regard' to the Commission's recommendations, which are not binding (section 46).	Appeals should be made to the CC on their merits, and they should take place after the regulator has taken its final decision (paragraph 10.303). Recommendations: *(a)* an appeal should lie to the CC; *(b)* the appeal should be against the regulator's decision; *(c)* the appeal should be against the merits of the regulator's decision; *(d)* the right of standing to appeal should lie in the relevant airport, in the individual airlines, and in designated passenger groups (and the DfT should therefore consider which groups to designate for this purpose); and while there are issues to be resolved about the number of appeals and un-meritorious appeals, those matters	New system of appeals. Appeal against a market power determination may be brought to the CAT (paragraph 1 of Schedule 1) by: *(a)* A person who is the operator of the area at the time the determination is made. *(b)* Any other person whose interests are materially affected by the determination. Based on: error of fact, wrong in law, error in the exercise of a discretion (paragraph 3 of Schedule 1). Appeal against a CAA decision on licence conditions may be brought to the CMA by: *(a)* a licence holder *(b)* a provider of air transport services whose interests are materially affected by the decision

	Airports Act 1986	Competition Commission 2009 Report	Civil Aviation Act 2012
		should be controlled through the CC's power to regulate its own procedure rather than through limitation of standing to appeal (paragraph 10.330).	(Sections 24 and 25) Based on: error of fact, wrong in law, error in the exercise of a discretion (Section 26) Appeal against a CAA decision regarding orders and penalties may be brought to the CAT (Schedule 3 and paragraph 1 of Schedule 5).
Powers of the CAA to enforce competition law	CAA had no powers to enforce competition law and make market investigation references in the airports sector. CAA only had concurrent competition powers in relation to air traffic services.	No specific recommendations	Section 60: Concurrent functions of the CAA and the CMA – functions under Part 4 of the Enterprise Act 2002 (market investigations) so far as they relate to the provision of airport operation services, other than functions under sections 166, 171 and 174E. Section 62: Concurrent functions under Part 1 of the Competition Act 1998 in relation to airport operation services. All airports in the UK covered by these provisions, (not just those which are subject to economic regulation) are covered by these provisions.

Glossary

ACI	Airports Council International.
AEC	Adverse effect on competition, as defined by section 134(2) of the Enterprise Act 2002.
Airports Act	Airports Act 1986.
Airport charges	Those charges defined by section 36(1) of the **Airports Act**. They are (broadly) charges levied on airlines in connection with the landing, parking or taking off of aircraft and charges levied on passengers in connection with their arrival at, or departure from, the airport by air.
Airport operator	The person for the time being having the management of an airport, or in relation to a particular airport, the management of that airport.
ASQ	Airport Service Quality. **ACI**'s ASQ measures passengers' satisfaction while they are travelling through an airport.
ATM	Air transport movement. A landing or take-off of an aircraft engaged in the transport of passengers, cargo or mail on commercial terms. All scheduled movements, including empty, loaded charter and air taxi movements are included in ATMs.
BAA	BAA Limited. Refers to the BAA group and any company in the group as appropriate (as it was then known). The successor to the British Airports Authority, from privatisation in 1987 to July 2006, when it was bought by a consortium led by **Ferrovial**. Now Heathrow Airports Holding Limited.
BIS	Department for Business, Innovation and Skills.
CAA	Civil Aviation Authority.
CAA12	Civil Aviation Act 2012.
CAA82	Civil Aviation Act 1982.
Capex	Capital expenditure.

CC	Competition Commission. From 1 April 2014 the CMA took over the functions of the CC and the competition and certain consumer functions of the OFT.
Charter service	A flight not operated as a regular scheduled service, some-times on an ad hoc basis. Seats are often sold through an intermediary, such as a tour operator.
CIP	Capital investment plan.
Commercial revenues	Income derived from commercial activities, ie airport activities that are not directly related to the aviation side of the airport's business, such as retail, duty-free sales, letting of hotels and offices and provision of car parks.
Contracts and Commitment framework	A framework devised by Gatwick Airport that consists of bilateral tailored contracts designed to deliver outcomes for airlines and passengers in terms of quality of airport, facilitities, service levels and price.
Cost of capital	The opportunity cost of an investment; that is, the rate of return that a company would otherwise be able to earn at the same risk level as the investment that has been selected.
Designated	Term used in reference to the **CAA82** where designation of airports for price control regulation would be decided by the Secretary of State for Transport. Heathrow, Gatwick and Stansted airports were designated and their price controls were set under the **Airports Act**. This continued to run until 31 March 2014.
DfT	Department for Transport.
DFS	Deutsche Flugsicherung GmbH – an air traffic control provider
DT	Divestiture trustee.
Enterprise Act	Enterprise Act 2002.
Ferrovial	Grupo Ferrovial, SA. A company quoted on the Madrid stock exchange. Former owners of **BAA**.
GIP	Global Infrastructure Partners.

Heathrow Airport Holdings Limited	Formerly **BAA**, Heathrow Airport Holdings Limited is the United Kingdom based operator of London Heathrow Airport. The name change took place in September 2012.
Hub airport	An airport used by airlines as the main base for connecting traffic where a significant proportion of passengers transfer between flights.
ICF	Consultancy service used by the CMA to support the evaluation
LCC	Low-cost carrier.
MAG	Manchester Airports Group, the operator of Manchester, East Midlands, Bournemouth and and Stansted airports.
Market Power Determination	The **CAA** is empowered to carry out a market power test, as set out in the **CAA12**, to determine whether an airport operator should or should not be subject to economic regulation.
MIR	Market Investigation Reference.
MT	Monitoring trustee.
OFT	Office of Fair Trading. From 1 April 2014 the CMA took over the functions of the CC and the competition and certain consumer functions of the OFT.
Open Skies	The air services agreement between the USA and the EU, effective from March 2008.
Opex	Operating expenditure.
Price cap	The maximum increase in airport charges allowed in each year, generally over a period of five years.
RAB	Regulatory asset base. The measure of the regulatory value of the company, based on its underlying assets. The RAB is a key element in setting the company's price caps: the cost of capital is applied to the RAB to generate a significant part of the company's allowable revenue.

Slot	The time of arrival or departure allocated to an airline by Airport Coordination Limited for the use of a runway at a congested airport.
SQR	Service quality rebate. A scheme under which an airport is required to pay rebates when specified standards are not achieved in particular months.
Transfer passenger	A passenger who changes, often at a hub airport, from one aircraft to another.
White Paper	The Air Transport White Paper The future of Air Transport, December 2003.