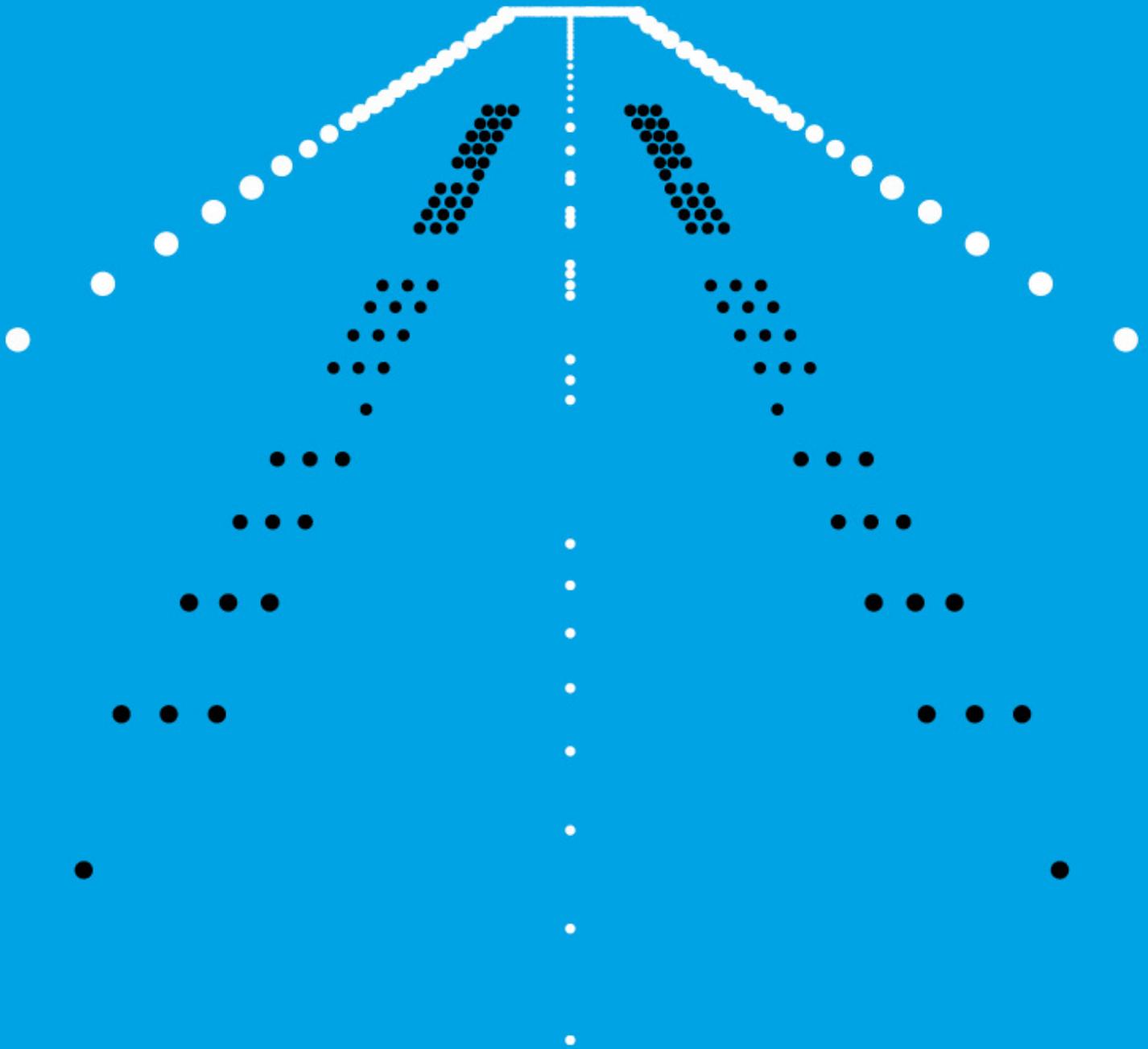


FLIGHT PATH TO GROWTH

LONDON FIRST SUBMISSION TO THE
AIRPORTS COMMISSION MAY 2013



London First

EXECUTIVE SUMMARY

New, privately-funded, runway capacity serving London, and the air links it provides, will improve Britain's ability to trade with the world, attract investment and generate economic activity that will create jobs. London First believes that, in the absence of a strategy to deliver new runway capacity in under a decade, the priority must be to find ways of increasing Air Traffic Movements (ATMs), where demand exists, through more intensive use of existing runways.

Our hub airport, Heathrow, has reached its planning cap but could support more flights and airline demand for slots is high. Common ownership, in the past, precluded competition between London's main airports. With this now ended, liberalisation, could create headroom for innovation, competition and choice by airlines and passengers, maximising the productivity of the current network of London airports. Meanwhile, better rail links to Gatwick and Stansted would strengthen these airports' ability to attract airlines and passengers.

We make six recommendations to the Airports Commission:

1 – The Commission should call on all parties to support and instigate the work needed to lift the planning cap on flights at Heathrow to permit more flights. Heathrow is the UK's international hub airport and is where demand is highest and capacity most constrained. Using both runways for take-off and landing ("mixed mode") could permit some 50,000 additional ATMs per year.

2 – The Commission should call on Heathrow to provide public assurance and concrete proposals that, under a higher ATM cap, the right balance can be struck between more flights and fewer delays. Operating at near capacity means that Heathrow has very little resilience against delays. If more ATMs are permitted, some of this potential capacity must be reserved to provide a buffer against the causes of delays, such as weather.

3 – The Commission should call on Government to review Heathrow's noise envelope in the context of a higher ATM cap; and to establish an independent regulator to enforce this new envelope when more flights are introduced. The number of people affected by aircraft noise from Heathrow has fallen by over 80% in the last 30 years. We believe that, even with an increase in ATMs, the number of people affected by noise and its intensity can be further reduced. However, in order to provide reassurance to residents, we recommend that an independent noise regulator be established by Parliament to enforce noise limits.

4 – The Commission should call on the Secretary of State to make an unequivocal statement supporting an increase in ATMs at Heathrow and to treat any application for the introduction of Mixed Mode under the 2008 Planning Act regime, on the basis that such an application is of national significance. To increase the number of ATMs permitted at Heathrow would require the Secretary of State for Transport to designate the move to mixed mode as a Nationally Significant Infrastructure Project. This enables numerous consents previously required for certain projects to be wrapped into one single Development Consent Order. In this way, the necessary increase in capacity could be achieved within five years.

5 – The Commission should recommend that Gatwick and Stansted be allowed to compete more effectively and should call on the CAA to apply the back-stop and price-monitoring powers it already has without imposing an economic licence. The economic regulation of London's main airports dates back to a time when all three were owned by one company. Since this is no longer the case, and neither Gatwick nor Stansted can be

considered to have market dominance, the regime should be liberalised so that they can compete effectively with each other and with Heathrow. This will encourage downward pressure on prices, increased choice, and the more extensive use of current capacity.

6 – The Commission should call on government and Network Rail to deliver a step change improvement in the capacity and quality of rail services to Gatwick and Stansted, strengthening these airports' ability to attract airlines and passengers. Rail services to Gatwick are hampered by poor quality rolling stock and uncertainty over the future of non-stop services. Stansted suffers from historic underinvestment in a slow service that does not operate at times of peak demand. Both should be brought up to the same standards as those serving other airports, notably Heathrow.

In conclusion, access to developing and developed markets is key to UK growth.

Our economic competitiveness demands that the UK's links to global markets continue to grow with a greater range and frequency of flights. The measures outlined above, if implemented, can begin to meet that need and strengthen the capital's ability to support and spearhead the UK's economic growth.

These measures are no substitute for a successful strategy for new runway capacity serving London. But the scale and urgency of London's need for that capacity require short-term action. Without such action, the growing economic cost of deferring a strategy to deliver new runways – already too great – will not be halted.

9 MAY 2013

LONDON FIRST SUBMISSION TO THE AIRPORTS COMMISSION – 9 MAY 2013

1. London First is a business membership organisation with the mission to make London the best city in the world in which to do business. We undertake our work with the support of the capital's major businesses in key sectors such as finance, professional services, property, transport and infrastructure, ICT, creative industries, hospitality and retail.
2. We welcome the chance to put our views to the Commission as it considers ways to “improve the use of existing runway capacity in the next five years – consistent with credible long term options”. We look forward to responding in the coming months to the Commission's thinking for the long term. The Commission faces, this year and next, the difficult task of building consensus for the trade-offs required to achieve the best outcomes for the UK at the lowest economic, social and environmental costs.
3. Our submission is informed by the conclusions of the Steering Group of business leaders London First established to examine the capacity and quality of London's transport infrastructure links¹; planning law advice from Herbert Smith Freehills LLP; research on noise mitigation commissioned from Arup; and wide-ranging discussion with London business and stakeholders.

INTRODUCTION

4. New runway capacity serving London, and the air links it provides, will grow Britain's ability to trade with the world, attract investment and generate economic activity that will create jobs. The private sector is willing to provide this capacity at scale without call on the public purse, while decisions by government enabling it to do so have been deferred, forgoing the national economic benefits new capacity will deliver.
5. At the same time, our rivals in Europe and elsewhere are securing new air links to high-growth markets while expanding established trade routes. The risk facing London and the UK is that businesses in growing economies, and the airlines that serve them, will make investment decisions over their European and international locations, and their flight patterns and primary airports, that will be difficult, if not impossible, to reverse.
6. In the short term we think the Commission's principal task is to mitigate this risk. It should determine how additional Air Traffic Movements (ATMs) can be facilitated where the market wants them through the more intensive use of current assets. This is no substitute for a long term strategy to deliver new runway capacity but, in the absence of that strategy, we see no choice. Policy drift will lead to the erosion of London and the UK's competitiveness.
7. We see three principal means of mitigating this risk in the next five years:
 - Lifting the cap on flights at Heathrow, the UK's only international hub airport, to allow the more intensive use of current runways so that there can be more long-haul flights;
 - Strengthening London's airports to compete by deregulating Gatwick and Stansted so that greater headroom for innovation and competition can stimulate new products and services and the more extensive use of existing runways; and
 - Delivering a step change improvement in public transport links to Gatwick and Stansted, further strengthening their ability to attract airlines and passengers

LIFTING THE CAP ON FLIGHTS AT HEATHROW

8. Heathrow is a hugely valuable asset to the economy. As the Commission's second discussion paper states, it is "by far our largest airport in terms of passenger numbers and accounts for around 70 per cent of passengers travelling to long-haul destinations". It provides direct connections to 75 destinations not served from any other UK airport and is used by over 90% of South East passengers travelling long-haul for business². It handles two-thirds of the country's air cargo (almost all of it in the holds of passenger planes), and almost a quarter of the UK's goods exports³.
9. As the country's only international hub airport Heathrow gathers a critical mass of demand in one location by pooling transfer passengers with local travellers to enable flights that would not be viable based on local demand alone. The benefit to London of having an international hub airport is that it enables Londoners to fly direct to a wide range of destinations without having to change planes, while providing a high frequency of flights on key routes.
10. In operational terms Heathrow has effectively reached its planning cap of 480,000 ATMs a year – it runs at about 98% of permitted utilisation. Under this cap Heathrow has around 650 flights each day between 7am-11pm. Noise quotas limit the period between 11pm-7am typically to around 45 flights (two thirds of which are early morning arrivals between 6-7am). Demand for ATMs has outstripped their availability for many years. New capacity would quickly be utilised and demand is set to grow. Heathrow's forecast for increased hub demand is 2.4% per annum to 2030, in line with the Government's own estimates and at the lower end of forecasts from other industry analysts⁴.
11. Frontier Economics⁵ has calculated that the UK risks forgoing trade worth at least £14bn by 2021 because of the inability to meet demand for flights at Heathrow. While there are inevitably high degrees of uncertainty around such forecasts we believe the economic cost to London and the UK of Heathrow's constraint is too great to ignore and is set to increase. We need additional hub capacity now.

Enabling more flights

12. Heathrow could support more ATMs than currently permitted in two ways:
 - First, through the concurrent use of both runways for take-offs and landings – so called Mixed Mode operation (almost all airports with two or more runways operate in Mixed Mode as opposed to Heathrow's Segregated Mode, whereby runways alternate between take-off and landing, to provide some respite from noise for local communities). Analysis by the UK's Air Navigation Service Provider NATS⁶, alongside Government-commissioned studies, concludes that Heathrow could support approximately 50,000 more ATMs a year through Mixed Mode without damaging reliability. This represents about 68 additional flights to the 650 or so flights now seen every day.
 - Second, through more flights between 11pm-7am. There is clearly demand from airlines to provide early morning arrivals from key business destinations in Asia and elsewhere. Any change to the current night noise management regime combined with the introduction of quieter planes could, in principle, provide further capacity for flights.
13. The precise mix of flights that would result from a higher ATM cap is impossible to predict, but would service at least 7 million more passengers a year, a large proportion of which are

likely to be business travellers, and tens of thousands more tonnes of cargo. These flights would expand the UK's ability to trade with and attract investment from new and established markets – amongst them the 26 emerging markets that are already served by daily flights from other European hubs but not from Heathrow.

Recommendation 1 – The Commission should call on all parties to support and instigate the work needed to lift the planning cap on flights at Heathrow to permit more flights.

14. We discuss briefly below the principal issues surrounding a lifting of the cap on Heathrow's ATMs.

Maintaining headroom to cut delays

15. Heathrow is currently over-scheduled and vulnerable to severe knock-on effects from delay, caused by anything from a technical fault to bad weather, or simply a late arriving flight. This over-scheduling is a result of packing more and more flights into the hours of operation in Segregated Mode. Utilisation has ticked upwards, from 275,000 ATMs in 1985 to close to 480,000 today.

16. Heathrow's management has in recent years applied considerable operational focus to improving punctuality. On average, flight delays have fallen around 10 per cent in the last two years⁷, but remain around 30 per cent worse than rival hub airports⁸, and it is still the case that in this period, on average, 1 in 10 flights was up to half an hour late and a similar proportion was an hour late. With such high demand for limited runway capacity, there is the paradox that a marginal extra slot at Heathrow delivers a high value for the acquiring individual airline, but imposes a much higher collective cost on all the airlines – and their passengers – through increased delay.

17. Global industry scheduling guidelines, EU and UK slot regulations leave little room fundamentally to alter the primary allocation of these slots. The allocation system gives airlines grandfather rights to slots and, on the basis that slots are used at least 80 per cent of the time, there is no means of retracting their use. Designated airports declare their available capacity season by season and slot allocation is then managed by an independent Coordinator⁹.

18. As demand for dwindling runway capacity at Heathrow has grown, the operational definition of punctuality has loosened to keep pace. So, for example, the aviation regulator, the Civil Aviation Authority (CAA), approved a doubling of the average time that planes can be queued in stacks above the airport, from five to 10 minutes; an element of overbooking was introduced to the declaration of available slots each season; and a wide 'conformance' window is now set for airlines to arrive and depart between -20 and +30 minutes either side of the schedule.

19. The lifting of Heathrow's cap on ATMs brings the opportunity for a step-change improvement in punctuality and the creation of new resilience. Early analysis by NATS indicates that, under a new ATM cap, Heathrow could support approximately 68 more flights per day and have sufficient headroom to maintain punctuality. Greater freedom to use runways between 11pm-7am could bring the potential for further headroom if flights were spread across a longer scheduling period.

20. Under a higher ATM cap, Heathrow should seek a better balance between greater headroom and more flights. The extent to which new headroom delivers comparable levels of punctuality and resilience seen at rival hub airports – and is preserved over time – will depend in large part on Heathrow's management. We believe Heathrow should declare its available capacity each season alongside targets for punctuality and the means to ensure they will be met. It could consider a number of approaches in doing so, for example:

- Taking a far more extensive sample of the previous season's delays – and including more elements of the passenger's journey in the definition of delay – before it states the next season's available capacity;
- Establishing a narrower window in which airlines should comply with the schedule – from its current -20 to +30 minutes – and putting in place an incentive mechanism for airlines to do so (taking into account Heathrow's ability to support the efficient turnaround of planes); and
- Seeking a ban on small business jets, which use Heathrow on an ad hoc basis and fill the buffers in the schedule that are there to help the airport recover from delay. General Aviation airports in London, such as London Biggin Hill, have the capacity to meet any displaced demand.

21. Firmer measures to maintain punctuality should be put in place in readiness for a higher ATM cap and additional slot capacity made available, on the basis of Heathrow's assurance – and, if necessary, oversight by the CAA – that punctuality can be maintained.

Recommendation 2 – The Commission should call on Heathrow to provide public assurance and concrete proposals that, under a higher ATM cap, the right balance can be struck between more flights and fewer delays.

Limiting and reducing the impact of noise

22. Key to lifting the cap on Heathrow's ATMs is public assurance – and confidence – that additional flights will not lead to either a material increase in the number of people affected by today's aggregate noise levels or an increase in the intensity of that noise. We believe this assurance could flow from a more effective means of calculating the impact of noise on communities; setting limits for, and reductions to, those impacts; and establishing an independent means of enforcement.

23. Noise standards are set internationally and given effect in EU and UK law. The Secretary of State is responsible for setting objectives on noise and night flight rules for Heathrow, Gatwick and Stansted. In tandem, in response to a European Environmental Noise Directive, these airports prepare noise action plans, based on noise contours, for adoption by the UK government. The noise contour for Heathrow encompasses those affected by average noise levels of at least 57dB¹⁰. This definition is based on UK government planning guidance and on research by the World Health Organisation.

24. Since 1980, the number of people affected by an average noise level of 57dB or more from Heathrow's aircraft has fallen from two million to around 250,000, despite a 75 per cent growth in flights (and continued housing development near the airport). This is primarily because aircraft manufactured today are much quieter than they were 20 to 30 years ago. These will, in turn, be replaced by even quieter aircraft in the future. The recent announcement¹¹ by International Airlines Group, which includes Heathrow's largest airline,

British Airways, of a £2.6bn order for Boeing 787s and partial replacement of its Boeing 747 fleet between 2017 and 2021 exemplifies the scale of change underway. The 787 is 40 per cent quieter than today’s similar-sized aircraft.

25. Detailed analysis by the CAA of the forecast changes in airline fleets at Heathrow¹² indicates that by 2020, even with 68 additional daily flights in Mixed Mode, the number of people affected by current aircraft noise levels will reduce¹³. Moreover, the number of those affected by the highest average noise levels¹⁴ will shrink by around 40 per cent – in part because the concurrent use of both runways will lower the intensity of aircraft noise (noise being spread across the day – at a lower average – rather than being concentrated in half the day, as now).

26. **Figure 1** translates Heathrow's noise thresholds into comparable experiences of noise, highlighting the levels at which the airport's noise contour of 57dB is set. Of course, aircraft produce peaks and troughs of noise as they pass overhead, so 57dB is an average noise level, within a range of around 45 to 70 dB.

Figure 1 - Noise levels - Decibel chart

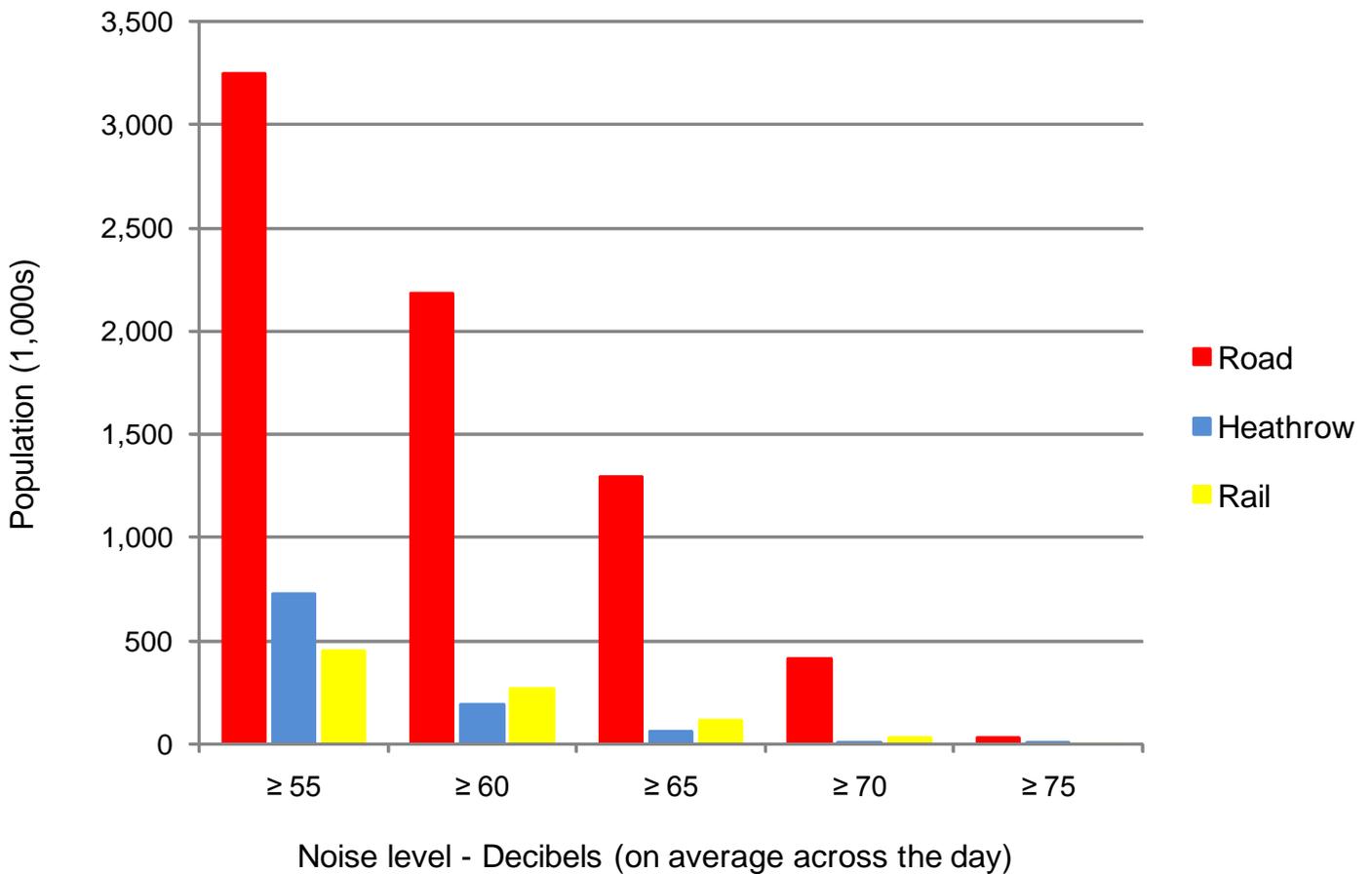
Noise (dB)	Activity
100	Jet takeoff at 500 metres
90	Very busy city street
80	Busy road junction
70	Noisy restaurant
60	Light car traffic at 15 metres Laughter / Normal conversation at 1 metre
50	Quiet office
40	Suburban area Kitchen / bathroom
30	Public library
10	Soft whisper at 10 metres
0	Threshold of hearing

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27. It is worth noting that similar average levels of noise from road traffic in London – measured in the same way across the day – affect over 2 million people; while similar average levels of noise from trains affect almost 300,000 people.

28. **Figure 2** compares the number of people affected by noise from road traffic and trains in London and from aircraft at Heathrow (Heathrow's figures apply to London as well as areas beyond the capital’s boundary; those for road and rail transport apply solely within London's boundary). Higher average levels of aircraft noise of 70dB – equivalent to a noisy restaurant – affect around 9,700 people. The same noise levels from road traffic affect more than 400,000; from trains, around 29,000.

Figure 2 - Estimated number of people experiencing noise from Heathrow in London and beyond; from Roads in London; and from Railways in London¹⁶



29. A significant proportion of noise (and air pollution) experienced by communities around Heathrow is generated by road traffic, although there is no holistic strategy from national or London government to tackle its impact. For example, it is broadly accepted that land use planning should resist noise-sensitive development – but while Heathrow's 57dB noise contour remained static between 1991 and 2001, the population within it grew by almost 27,000 (10%) during this period¹⁷.

30. Runway alteration currently gives residents nearest Heathrow a half day of relative respite from noise, in exchange for greater noise intensity during the other half of the day. Clearly, with Mixed Mode will come changes in airspace use – and, therefore, winners and losers – and predicting the development and uptake of new technology is inherently difficult, given the complexity of economic and environmental interdependencies. But there are good grounds for believing that fleet replacement, combined with the application of technology and operating procedures that allow for narrower noise corridors and the more efficient ascent and descent¹⁸ of aircraft, can prevent any increase in Heathrow's aggregate noise from today's footprint, even with more flights under a higher ATM cap.

31. Nonetheless, in tandem to lifting Heathrow's ATM cap, we think additional action is required: first, to apply innovative approaches to cut noise to enable more flights; and, second, to deliver greater public confidence that targets set will be met.

32. On managing noise, and in parallel with a planning consent for Mixed Mode, a new method of assessing the impact of noise should be established that gives certainty to local communities. The government has indicated it wishes to pursue the concept of a “noise envelope”¹⁹ that would provide a more comprehensive calculation. Noise envelopes could incorporate more than a contour map – for example, the number of ATMs or passengers or a set of individual responses to noise events – and should be tailored to the characteristics of each airport.
33. With this envelope set for Heathrow, a range of possible measures is available to ratchet down the impact of noise within it, for example:
- More extensive fees based on an aircraft's noise impact on landing (landing charges currently account for around 19 per cent of Heathrow's total regulated charges);
 - Larger penalties or rewards for meeting more stringent noise limits on departures (these are currently unregulated charges set by government in consultation with the industry);
 - Restrictions to ban certain planes causing the greatest noise disturbance at a particular time of day or within an overall quota²⁰; or
 - The pooling of noise-related levies to fund an increase in noise insulation in surrounding areas.
34. Critically, the development of a noise envelope should open a new, creative approach to meeting the needs of residents. For example, a higher ATM cap may generate the scheduling flexibility to ban flights for certain hours of the night or day while enabling more flights overall; or residents may view fewer early morning flights as preferable to more flights, less noticeable during the day. The degrees of freedom enabled by a noise envelope combined with a higher ATM cap should be fully explored.
35. On building public confidence, we believe an independent noise regulator should be created by Parliament, independent of the industry and separate to the CAA. The regulator would enforce the noise envelope set by government. It would both report on noise, in a manner that was transparent and intelligible to local communities, and have the powers to direct Heathrow to introduce additional measures to reduce noise should the noise envelope be breached, with compensation where appropriate.

Recommendation 3 – The Commission should call on Government to review Heathrow's noise envelope in the context of a higher ATM cap; and to establish an independent regulator to enforce this new envelope when more flights are introduced.

36. By commencing work to develop a noise envelope ahead of the Commission's final report in 2015, the government would be in a position to accelerate delivery of its Aviation National Policy Statement (NPS), given that it wishes to incorporate the principles for the noise envelope in the NPS²¹. The government should draw on measures taken to manage noise at airports around the world. Research from Arup puts some of these in context and the following examples indicate the range of options being pursued:
- In Amsterdam, Frankfurt and Brussels, regional and local authorities play a role in establishing local environmental limits for these airports as well as compensation. In Amsterdam the representative panel of residents and municipalities (the Alders Platform), with Schiphol airport, advises the government on the balance it should strike between

growing flights and the measures required to limit and reduce their local environmental impact.

- In other parts of Europe and in North America, airports have established a transparent means of communicating and tracking efforts to limit and reduce noise. Zurich airport monitors departure flight paths and publishes the number of deviations, the proportion of these deviations investigated, the number of cautions issued and number of cases reported to the aviation regulator. San Francisco runs a fleet noise quality assurance programme, evaluating and publishing the noise contribution of each airline. Chicago O'Hare publishes hourly noise monitoring site reports with statistics presented in easily understood diagrammatic form alongside noise contours and the number of aircraft noise events greater than 85dB and 65dB.
- In France, Holland, the US and Australia, national noise taxes and charges are levied on airlines or passengers, according to airport and noise levels. Revenues are hypothecated and fund sound insulation programmes. Around Paris Charles de Gaulle, for example, over 15,000 homes and public buildings have been insulated since 1995 at a cost of €151 million. Around Amsterdam Schiphol, 12,000 homes have been insulated in the last 30 years at a cost of €622 million. In Chicago, the Midway Noise Compatibility Commission, established by the Mayor, oversees the insulation programme funded by the federal Passenger Facility Charge. All three airports have, in parallel, expanded their operations with new runways.

Gaining planning consent

37. A proposal to lift the current cap on ATMs would require a variation of the planning permission granted by the Secretary of State for Transport in 2001 for the construction of Terminal 5 at Heathrow²². We believe the most feasible and comprehensive route to gaining this variation would require less than five years.
38. The 2008 Planning Act introduced a consenting regime for Nationally Significant Infrastructure Projects, under which numerous consents previously required for certain projects are wrapped into one single development consent order (DCO). Airport-related development falls within the scope of the Act if it involves the construction of an airport – or alterations to an airport – that deliver new capacity for at least 10 million passengers a year or air cargo transport services of at least 10,000 ATMs a year²³.
39. Additional flights at Heathrow through Mixed Mode would not necessarily increase the airport's capacity by these amounts. Nonetheless, the Secretary of State has the power under the Act to make a direction that lifting the ATM cap and the introduction of Mixed Mode be treated as development for which development consent is required – on the basis that he considers the project to be of national significance. Under such a direction, the Secretary of State would determine the application for development consent.
40. Treating an application for a higher ATM cap as a nationally significant infrastructure project would establish a process with a fixed timetable and deadlines for a decision. It would include an extensive pre-application consultation (requiring a minimum of 12 months) and hearings on any actual application. The local planning authority (the London Borough of Hillingdon) would play an active role in proceedings and appropriate consultation would be required by the application's promoter. The Secretary of State's decision on an application must then be made within 15 months of its receipt.

41. Any application for a DCO would necessitate a review of the development's impacts on various counts including noise, air pollution, transport and climate change. It would also need to be accompanied by an Environmental Statement.
42. From the advice we have taken, we believe the entire process could be completed in under five years – albeit with a risk that judicial review could delay implementation.

Recommendation 4 – The Commission should call on the Secretary of State to make an unequivocal statement supporting an increase in ATMs at Heathrow and to treat any application for the introduction of Mixed Mode under the 2008 Planning Act regime, on the basis such an application is of national significance.

STRENGTHENING LONDON'S AIRPORTS TO COMPETE

43. In its new Aviation Policy Framework the government has the stated objective of ensuring the UK's air links "continue to make [Britain] one of the best connected countries in the world". It believes meeting this aspiration will require both the maintenance of "the UK's aviation hub capability" and the development of links from airports that provide point-to-point services. It sees "considerable scope for airports other than Heathrow to develop long-haul services to a broader range of destinations to support the UK's international connectivity"²⁴. We believe this aspiration can be supported and delivered by market liberalisation with the removal of price control regulation from Gatwick and Stansted.
44. London has the largest airports market in the world²⁵. While complex and segmented, it possesses substantial scope for competition – not least given the capital's airports are now all in separate ownership; and that in some cases plans are underway to increase their effective utilisation. For example, London City Airport was granted permission in 2009 to support 120,000 ATMs a year and has put forward development proposals to support its growth to this cap.
45. We think Heathrow's dominance as the UK's only international hub airport justifies price regulation, but do not believe there is compelling evidence that Gatwick and Stansted have market power that requires the continuation of price controls or an economic licence. Liberalisation would generate new headroom for innovation and greater flexibility to invest according to need. It would enable greater competition between all London's airports for airlines and services, resulting in a downward pressure on prices; increased choice; and the more extensive use of current capacity.

The scope for competition

46. Faced with the wealth of evidence and analysis produced by the Competition Commission (CC)²⁶ in its market investigation of the British Airports Authority (which, at the time, owned Heathrow, Gatwick and Stansted), and by the CAA²⁷ in its contribution to that investigation, we believe the prima facie case for deregulating Gatwick and Stansted is strong. After a two year investigation, the CC recommended in 2009 that BAA's common ownership of London's airports be ended (with the divestment of Gatwick and Stansted), having concluded that monopoly ownership was producing 'adverse effects on competition'. It saw then – and again in 2011, following legal challenge – scope for competition. Indeed, it concluded that "If Gatwick and Stansted were in competition with one another, we would expect airlines to use the existence of spare off-peak capacity at each airport during the course of their negotiations to secure more generous unpublished discounts [which] could lead to lower average prices at both airports and better capacity utilisation".

47. In assessing the scope for competition, and the risks to consumers of market power abuse, the CC saw two primary constraints on an airport's ability to increase charges or reduce quality to the detriment of passengers: firstly, airlines' ability to change services or switch location; and secondly passengers' ability to choose between airports.
48. On the first of these, it saw evidence of switching by airlines within London, even in the limited runway capacity of the time. It noted that the growth of Low Cost Carriers (LCCs) had led to intensive price competition between airports for their business, given airport charges represent a relatively large component of LCCs' costs and LCC passengers are likely to be price-sensitive. Gatwick's biggest airline, easyJet, accounts for over a third of its passengers; Stansted's two biggest airlines, Ryanair and easyJet, account for over 90 per cent of its passengers.
49. On the second of these, it saw competitive interactions between Heathrow, Gatwick and Stansted greater than those at non price-capped airports elsewhere in the UK. It also provided evidence of large catchment overlaps between London's three largest airports²⁸ and the willingness of passengers, particularly leisure passengers, to consider, and travel to, two or more of them.
50. In its responses to the CC's findings, the CAA saw substantial scope for competition between Heathrow, Gatwick and Stansted – and greater scope for price competition than envisaged by the CC. It argued that, with divestment, there could be a case for withdrawing from sectoral regulation and relying on competition – and competition law – to protect the interests of consumers and that price controls can distort investment decisions and reduce incentives to innovate. In 2007 it recommended that Stansted be deregulated, believing that the airport did not possess substantial market power and was unlikely to do so for the foreseeable future, given competitive constraints in the market.

The situation today

51. We think the conclusions of the CC and the CAA are persuasive in themselves and should inform the Commission's thinking, as liberalisation has the potential to increase the effective capability of our airports in the short, as well as the longer, term.
52. The justification for economic regulation rests on a determination of market dominance by the CAA. Under the recently enacted Civil Aviation Bill, the burden of proof is on the CAA²⁹. Fundamentally, we do not think the regulator has provided a substantial case that either Gatwick or Stansted possess market dominance requiring an economic licence (the CAA has reversed its 2007 position and is now minded to conclude that Stansted has dominance). A dominant position is considered to derive from a combination of factors, the most important of which are listed below.
53. Substitutability: the extent of competition between airports depends in large measure on the extent of substitutability between them. There is significant substitutability, with large catchment overlaps, between Heathrow, Gatwick and Stansted. As the CAA recently concluded when granting easyJet its bid to run services from Gatwick to Moscow over Virgin Atlantic's bid to do so from Heathrow (adding to those provided by British Airways at Heathrow): "easyJet's proposal would introduce a new product into the market and would be more likely to stimulate innovation on the route as a whole... the CAA considers that Gatwick and Heathrow can be considered to be in the same market, and therefore that there will be competition between services from the two airports"³⁰.

54. High market share: can indicate dominance. By the CAA's analysis Gatwick possesses 30 per cent of the SE passenger market, Stansted around 20 per cent – in both cases below the levels usually associated with dominance. The CAA notes that in the short haul and low-cost market segments both airports have a much higher market share. But total substitutability is high across all airports, and it is highest when it comes to leisure passengers who are frequent users of short haul and low cost services; are more sensitive to price; are more willing to travel further to get to the airport; and are most likely, therefore, to be the 'marginal' passengers (it is generally accepted that competition policy should focus on the substitutability of marginal passengers, rather than non-marginal passengers who have a strong preference for an airport).
55. Airline buyer power: can indicate levels of airport dominance. Gatwick and Stansted face significant buyer (and bargaining) power from airlines, which constrains their ability to raise prices to supra-competitive levels. These airlines can switch, change or reduce services such that airports see a fall in both charges and commercial revenue.
56. Switching costs: may create a barrier to competition. Low cost airlines and charter airlines, which dominate Gatwick and Stansted, face relatively low switching costs. Substantial churn over the last decade suggests these costs do not present a barrier to competition (and, conversely, reinforce these airlines' buyer power). Long haul airlines face relatively high switching costs. But BA and Virgin for example, are both customers of Gatwick but base their main operations at Heathrow, giving them options to merge or switch services. Lifting Heathrow's ATM cap would grow their options as well as their buyer power.
57. Scarce capacity: and excessive demand for it may enable airports to raise prices, but both the CC and the CAA concluded there was scope for competition between London's three largest airports within the capacity constraints of the time. There has subsequently been a significant growth in spare runway capacity at Stansted and Gatwick continues to have off-peak capability. At Heathrow, there remains terminal capacity for around 10 million more passengers a year and a higher ATM cap would increase competitive pressures on Gatwick and Stansted in the short and medium term.

Allowing flexibility and redress

58. Gatwick has recently offered all its airlines (and passengers) a set of commitments on service quality, performance and capital investment – and with them a limit to the charges it will impose on airlines that sign up to them. Gatwick's Conditions of Use would include these commitments. Should Gatwick fail to comply, airlines would enter a speedy dispute resolution process, with an independent adjudicator determining the dispute to a fixed deadline (and where resolution cannot be reached, a court doing the same). It would also still be open to the CAA to make a fresh market power test and a new determination.
59. Gatwick has also offered airlines the option to enter into long term bilateral contracts – establishing commercial arrangements on price and service standards – allowing outcomes to vary through higher or lower charges (as well as the option to share risk and reward). We think these commitments, and the flexibility afforded by bilateral contracts tailored to the planning and investment cycles of airlines, further strengthen the in-principle case for removing price controls.
60. In summary, we believe the CAA already has considerable powers to intervene – and sufficient back-stop and price-monitoring powers now – without having to impose an economic licence on Gatwick or Stansted. We agree with the CAA's conclusion that

exclusionary behaviour that threatens the interests of consumers can, in principle, be tackled adequately by competition law alone. We think the CAA should follow this logic and allow the market to flourish. While it has recently proposed a more flexible regulatory approach, it has nonetheless set detailed expectations for pricing and behaviour; maintained the option to revert to price caps if these expectations are not met; called on Stansted to develop flexible commercial contracts with airlines and to self-regulate; but remained unwilling at this point to accept Gatwick's proposals to do the same³¹.

Recommendation 5 – The Commission should recommend that Gatwick and Stansted be allowed to compete more effectively and should call on the CAA to apply the back-stop and price-monitoring powers it already has without imposing an economic licence.

DELIVERING A STEP-CHANGE IMPROVEMENT IN PUBLIC TRANSPORT LINKS

61. Finally, we think policy change and further investment is required to improve the quality of public transport links to Gatwick and Stansted. In 2006 the Eddington Study highlighted the urgent need to improve the UK's key international gateways with better road and rail access. It is hard to avoid the conclusion that transport policy has paid insufficient attention to this need.

62. Principally we think the quality of rail services to Gatwick and Stansted should be raised, to levels seen elsewhere at London's airports and internationally, to strengthen these airports' ability to attract airlines and passengers. In the absence of a comprehensive national strategy to improve rail access to all our major airports we outline below the immediate changes required.

Gatwick

63. A third of all passengers travelling to Gatwick do so by train; the Gatwick Express handles half of them and is heavily utilised by business passengers. The quality of express services compares poorly with equivalent services to Heathrow, and internationally. Rolling stock is not designed for air passengers; information and ticketing often fails to meet expectation or need; and the quality, access and configuration of the station do not support a premium-priced offer. In that context:

- The new Thameslink franchise specification should mandate a premium, dedicated, non-stop service between Gatwick and Victoria – with, at the very least, four trains per hour and a 30 minute journey time. To support this mandate, and in advance of the franchise's start next year, government and Network Rail should strike the necessary balance between express and commuter services and government should commit to the provision of high-quality rolling stock for the Gatwick Express.
- The completed upgrade of Gatwick's rail station this year, with the addition of a seventh platform, should instigate a step change improvement in its management by Network Rail and the airport to improve the passenger experience, with, amongst other things, the removal of concourse ticket gates which neither the airport nor the train operator view as necessary and which preclude a highly-valued walk-on service.

Stansted

64. Half of all passengers travelling to Stansted do so by public transport, and a quarter of all passengers do so by rail. The infrastructure supporting these rail services has suffered

from decades of underinvestment, and substantial efforts by the current operator are focused on maintaining reliability. In the short term, raising the quality and capacity of services will require detailed and sustained collaboration between Network Rail, the airport and the train operator. In the long term, there must be additional investment. Both will be required to cut the journey time of 47 minutes on Stansted Express services from the City of London. In that context:

- Network Rail and the train operator should agree and commit to short-term improvements in the quality and reliability of services to Stansted. These improvements should come with new targets for punctuality which at the very least match the national average, and the means to meet them. They should include an extension of early morning services to meet peak demand for air passengers and an early cut in the journey time provided by the Stansted Express.
- At the same time, government should commit to a credible plan to deliver a 30 minute journey time on express services between the City of London and Stansted, on a par with similar services to Gatwick and should assess, before Network Rail's next regulatory control period, the case for additional investment in infrastructure required to deliver it.

Recommendation 6 – The Commission should call on government and Network Rail to deliver a step change improvement in the capacity and quality of rail services to Gatwick and Stansted, strengthening these airports' ability to attract airlines and passengers.

CONCLUSION

65. Our economic competitiveness demands that the UK's links to global markets continue to grow with a greater range and frequency of flights. We think the measures outlined above, if implemented, can begin to meet that need and strengthen the capital's ability to support and spearhead the UK's economic growth. These measures are no substitute for a successful strategy for new runway capacity serving London. But the scale and urgency of London's need for that capacity require short-term action.

66. Our hub airport, Heathrow, has reached its planning cap but could support more flights. Common ownership, in the past, precluded competition between London's main airports – with this now ended, liberalisation, could create headroom for innovation, competition and choice by airlines and passengers and the more extensive use of current assets. While better rail links to Gatwick and Stansted would strengthen these airports' ability to attract airlines and passengers, furthering the use of these assets. Without these changes, the growing economic cost of deferring a strategy to deliver new runways – already too great – will not be halted.

- ¹ London's Connectivity Commission published its report London, Britain and the world: Transport links for economic growth in February 2012. It can be found at www.londonfirst.co.uk.
- ² OAG Airline Schedules Database, from analysis by Heathrow Airport Ltd, October 2012; CAA Passenger Survey 2011, HAL Analysis, February 2013.
- ³ By value to non-EU countries (detailed HMRC data is only available for non-EU trade flows). Air Freight, Economic and Environmental Drivers and Impacts, Steer Davies Gleave, March 2010.
- ⁴ Boeing, 2012; International Air Transport Association (IATA), October 2012; Federal Aviation Administration (FAA), 2012.
- ⁵ On behalf of Heathrow.
- ⁶ Heathrow Airport Mixed Mode Study, 2007.
- ⁷ UK Punctuality Statistics, 2010-2012, CAA. 'On time' is here defined within 15 minutes of the schedule.
- ⁸ With average departure delays of 12.5 minutes, and arrival delays 13 minutes, in 2012. Comparison made with Paris Charles de Gaulle, Frankfurt, Amsterdam Schiphol from CODA Digest, Delays to Air Transport in Europe, Eurocontrol, Annual 2012.
- ⁹ Airport Coordination Limited (ACL) is an independent company owned by 9 of the UK's leading airlines who each contribute towards its operation. It is a quasi-private body carrying out a public function. Slot allocation is done through discussion and negotiation with the airlines, while applying the specific rules set out in European regulations and worldwide scheduling guidelines.
- ¹⁰ The level above which the UK government considers that communities become significantly annoyed by aircraft noise is 57dBALeq. "Leq" stands for equivalent continuous sound level, measured in decibels (dBA), for a period of 16 hours across a typical day in the summer.
- ¹¹ International Airlines Group reaches agreement with, Guardian, 3 April 2013.
- ¹² ERCD Report 0705, Revised Future Aircraft Noise Exposure Estimates for Heathrow Airport, Environmental Research and Consultancy Department, CAA, November 2007. It is expected that by 2020, over 90 per cent of aircraft at HRW will be Chapter 4 compliant - the highest international standard for noise emissions.
- ¹³ Within the 'daytime average noise' contour of 57db currently used for planning purposes.
- ¹⁴ 69dBALeq.
- ¹⁵ Variety of sources.
- ¹⁶ Data sourced from DEFRA, quoted in: Heathrow Airport Environmental Noise Directive Noise Action Plan 2010-2015, December 2010.
- ¹⁷ Noise Road-Map - A Blueprint for Managing Noise from Aviation Sources to 2050, Sustainable Aviation, April 2013.
- ¹⁸ Continuous Descent Approach (CDA).
- ¹⁹ Defined by input measures such as plane/passenger numbers; the measurement of noise itself; and dose-response relationships between noise events and their impact. Insight note: Aviation policy for the environment, CAA, December 2011.
- ²⁰ EU Directive 2002/30 enables airports to apply for restrictions by flight or time of day.
- ²¹ Aviation Policy Framework, Department for Transport, March 2013.
- ²² Condition A4 of that permission states that "from the date that the Core Terminal Building opens for public use, there shall be at Heathrow Airport a limit on the number of occasions on which aircraft may take-off or land at Heathrow Airport of 480,000 during any period of one year".
- ²³ Section 23 Planning Act 2008.
- ²⁴ Aviation Policy Framework, Department for Transport, March 2013.
- ²⁵ By passenger number.
- ²⁶ BAA airports market investigation: A report on the supply of airport services by BAA in the UK, Competition Commission March 2009.
BAA airports market investigation: Appendix 3.3 - Airport competition case studies, Competition Commission, March 2009.
BAA airports market investigation: Appendix 3.5 - Detailed analysis of BAA's south-east airports, Competition Commission, March 2009.
BAA airports market investigation: Appendix 3.5 - Scope for competition between BAA's London airports within current constraints, Competition Commission, March 2009.
BAA airports market investigation: Provisional consideration of possible material changes of circumstances, Competition Commission, March 2011.
- ²⁷ Empirical methods for assessing geographic markets, in particular competitive constraints between neighbouring airports, CAA, 2006.
The Competition Commission's Market Investigation of BAA: A submission by the Civil Aviation Authority, CAA, May 2007.
The Competition Commission's Market Investigation of BAA Ltd: A submission by the Civil Aviation Authority on Economic Regulation of UK airports, CAA, February 2008.
The Competition Commission's Market Investigation of BAA Ltd: The Civil Aviation Authority's response to the Provisional Findings and Remedies Notification, CAA, September 2008 and December 2008.
The Competition Commission's Market Investigation of BAA Limited: The Civil Aviation Authority's response to the Provisional Decision on Remedies, CAA, January 2009.
Responses to provisional consideration of possible material changes of circumstances, CAA, April 2011.
- ²⁸ Based on possible and actual journeys; and confirmed by isochrone, catchment area and passenger choice analysis from the CAA.
- ²⁹ The Bill sets three tests that must be met: 1. That the airport has, or is likely to acquire, substantial market power in a market; 2. That competition law does not provide sufficient protection against the risk that the airport may engage in conduct that amounts to abuse of that substantial market power; and 3. That for users, the benefits of regulating the airport by means of a licence are likely to outweigh the adverse effects.
- ³⁰ Decision on scarce capacity allocation certificates, CAA, October 2012.
- ³¹ Economic regulation at Gatwick from April 2014: Initial proposals; Economic regulation at Stansted from April 2014: Initial proposals, CAA, 30 April 2013.