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**IN THE COMPETITION**

Case No. 1185/6/8/11

**APPEAL TRIBUNAL**

Victoria House  
Bloomsbury Place  
London WC1A.2EB

Monday, 5<sup>th</sup> December 2011

Before:

THE HON. MR. JUSTICE SALES  
(Chairman)

WILLIAM ALLAN  
JOANNE STUART

Sitting as a Tribunal in England and Wales

BETWEEN:

**BAA LIMITED**

Applicant

and

**THE COMPETITION COMMISSION**

Respondent

Supported by

**RYANAIR**

Intervener

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**HEARING - DAY ONE**

## **APPEARANCES**

Mr. Nicholas Green QC and Mr. Martin Chamberlain (instructed by Herbert Smith LLP) appeared on behalf of the Applicant.

Mr. Daniel Beard QC and Mr. Alan Bates (instructed by the Treasury Solicitor) appeared on behalf of the Respondent.

Mr. Paul Harris QC and Miss Sarah Love (instructed by Nabarro LLP) appeared on behalf of the Intervener.

1 THE CHAIRMAN: Yes, Mr. Green.

2 MR. GREEN: Good morning, I appear today for BAA with Mr. Martin Chamberlain.

3 Mr. Daniel Beard QC and Mr. Alan Bates appear for the Competition Commission.

4 Mr. Paul Harris QC and Miss Sarah Love appear for Ryanair.

5 I wish to start by explaining how I am going to structure my submissions. There are a  
6 number of introductory matters that I am going to address. I will then address the law and  
7 then I will get down to dealing with the individual grounds. So far as the grounds are  
8 concerned, I am going to take them in this order: ground one, ground four, ground two and  
9 then ground three, and I will explain the reason for that as I come to it.

10 A great deal of the burden of this case does involve tracking backwards and forwards  
11 between the 2011 and the 2009 Commission reports, and there is, in addition, analysis in the  
12 2008 Commission investigation into charges at Stansted, which is also relevant. The  
13 Competition Commission has referred to and relied upon it. These reports are, to put it  
14 mildly, lengthy. They are detailed and in many respects they are repetitive. In 2009 the  
15 Tribunal categorised key parts of the proportionality analysis as “diffuse and exiguous”.  
16 Attempting to extract the points from the various reports can be time consuming and  
17 difficult.

18 Two observations flow from this. First, when one reads the Commission reports, certainly  
19 at first blush, they appear plausible, convincing even. However, as one turns over the  
20 stones one discovers all sort of illogicalities, omissions and empty assertions. This is what  
21 the Tribunal found when it examined the Commission’s reports in *Tesco* and in *Barclays*,  
22 and it is what the Tribunal found in relation to the OFT’s merger decisions, for example in  
23 *UniChem*.

24 What I am going to do is to unpick the Competition Commission’s own reasoning. I am  
25 going to be relying almost exclusively on the Commission’s own findings and own analysis.  
26 You will have seen from the Commission’s pleadings and their skeleton that they are  
27 relying ever more heavily upon their margin of discretion. It is absolutely correct that they  
28 have a margin of discretion. There is no doubt about it, we do not challenge that. It is  
29 described as “wide” by the Tribunal in *Tesco*. In their skeleton the thrust of their argument  
30 seems to be that because it is all so blindingly obvious all the Commission had to do was a  
31 quick rough and ready examination of its 2009 report, a little bit of up to date factual  
32 enquiry and it could then justify coming to precisely the same conclusion in 2011 as it did  
33 in 2009, notwithstanding the material change of circumstance. This judicial review is  
34 governed by a statutory framework, which tells the Commission what its task is.

1 The case law of this Tribunal goes further and explains that the essence of the  
2 Commission's task is a proportionality exercise, and the case law breaks that down into four  
3 express conditions. The case law goes further and it indicates what sort of matters the  
4 decision maker, the Commission, must examine when applying the proportionality test. All  
5 the Tribunal does is hold the Commission to its task. It requires the Commission to perform  
6 its task properly and conscientiously. So there is a discretion undoubtedly, but it is curtailed  
7 by the statutory framework, and the guidance given by the Tribunal as to how that statutory  
8 framework applies.

9 Our submissions rely exclusively on very traditional judicial review grounds. The judicial  
10 review grounds have been elaborated upon by the Tribunal in a number of cases, most  
11 recently *Barclays* and *Tesco*, and they were neatly encapsulated by the Tribunal in that  
12 judgment, in the *Tesco* judgment, as, in essence, requiring the Commission to put itself into  
13 a position where it could answer the statutory question properly. In many respects, when  
14 one identifies an issue with the Commission's reasoning, it does not matter whether one  
15 says there are inadequate reasons, or whether they have misdirected themselves to a prior  
16 part of their previous analysis, or they have failed to take something into account which  
17 they had previously found. I think the Tribunal was correct to say it often boils down to,  
18 were they in a position properly to answer the statutory questions which are required of  
19 them?

20 I would like to start by, as it were, standing back from the fray and just seeing how the  
21 Tribunal put it in *Tesco*, and then, in a rather useful formulation, in *UniChem*. Can I ask  
22 you, please, to look at authorities bundle 2, tab 26, which is *Tesco*, paras.138 and 139,  
23 pp.45-46. This is under the heading, "The Tribunal's discussion and conclusions", and the  
24 first three paragraphs of that section simply say, first, that the Commission accepts that it  
25 must act in a proportionate manner, secondly, the Tribunal refers to the European Court of  
26 Justice's equivalent ruling in *Fedesa*, and then, thirdly, the Tribunal identifies the four main  
27 conditions, or four main aspects, of the proportionality principles, and I will return to those  
28 in a little while.

29 Paragraphs 138 and 139 encapsulate two things: first the Commission's discretion and  
30 secondly the limits thereof. I am going to read them and then take you to *UniChem*.

31 THE CHAIRMAN: It is probably a little bit quicker, shall we read those now?

32 MR. GREEN: Yes, certainly. Thank you very much. (Pause) Four main points are made in  
33 those paragraphs. First in para.138 the Tribunal recognises the discretion which the  
34 Commission properly has. Secondly, (and I put down, as it were, a forensic marker) in the

1 middle of the first part of 139 there is a reference to the Treasury Green Book, which is a  
2 document I am going to refer you to later. The point is made there, and we entirely accept,  
3 that it is not a document which binds the Competition Commission; it is something they  
4 may have regard to.

5 Thirdly, the Tribunal refers to the principle of double proportionality, which is no more than  
6 a principle of common sense, namely that the more intrusive the remedy, the more wide-  
7 ranging the remedy, the more detailed or deeper the investigation of the facts in question  
8 may need to be. We will be submitting that in the present case the Commission is imposing  
9 the most draconian remedy which it has ever, in its history imposed, in terms of scale and  
10 extent and intrusiveness. On any analysis of double proportionality the Commission was  
11 required to conduct a detailed analysis and the Tribunal is required to hold it to a detailed  
12 analysis.

13 Then fourthly, the point that I started with: ultimately the Commission must do what is  
14 necessary to put itself into a position properly to decide the statutory questions. As the  
15 Commission itself accepts, this includes examining and taking account of relevant  
16 considerations such as the effectiveness of the remedy, the time period within which it will  
17 achieve its aim and the extent of any adverse effects that may flow from its implementation.  
18 That is *Tesco*.

19 I would like to show you the way in which the Tribunal encapsulated a similar principle in  
20 *UniChem*, which is authorities bundle 1 tab 22. I would like to take you to para.278.  
21 *UniChem* is an important judgment because it demonstrates the general approach of the  
22 Tribunal to the proper fact finding trial, the decision maker. It demonstrates that in a  
23 complex economic decision it is necessary to break it down into its component parts and, as  
24 I put it, it holds the regulator to a conscientious and proper task. But in para.278 (p.98 of  
25 the judgment) the Tribunal said as follows:

26 “While it is strongly arguable that the uncontested matters to which we have  
27 referred above support the conclusion that the OFT’s Decision remained within  
28 the bounds of reasonableness, in our view it is difficult to overlook the contested  
29 matters of fact raised by *UniChem* which are material to the OFT’s reasoning.”

30 If I could pause for a moment, the submission was made that the Office of Fair Trading, in  
31 analysing the merger, had failed to take account of material put to it by the party that knew  
32 most about the relevant facts. It simply ignored a category of facts. They were contested.  
33 The Tribunal said, “We cannot possibly decide who is right and who is wrong, but you

1 failed to address your mind to a relevant category of factual evidence which is contested”.

2 This led to the following observation:

3 “In our judgment, in the final analysis, the OFT did not know enough about the  
4 reach and logistics of UniChem's network and the economics of delivery  
5 routeing to have an adequate factual basis for its Decision. In addition, we  
6 regard the OFT’s omission to seek comments from UniChem on those matters,  
7 and on the other matters we have mentioned above, as being of decisive  
8 importance.”

9 So failing to know enough to have a factual basis to answer a statutory question – another  
10 way of putting the *Tesco* formulation really.

11 The second introductory observation that I wish to make is that in order to help the Tribunal  
12 through the very large number of references to evidence that one has to grapple with to  
13 understand what really went on in this case, I have reduced my notes to a speaking note.

14 This contains all the references to the evidence, and I have set out quite a lot of the  
15 paragraphs that I will be particularly relying upon, and I am going to hand it up in a  
16 moment. I am going to be working closely from this note. The Commission in its defence  
17 have accused BAA of being selective in its approach to the evidence, and I have  
18 endeavoured in my note certainly to ensure that we provide a comprehensive review of the  
19 evidence so you can track backwards and forwards without having to have the documents in  
20 front of you. Of course, as I work through it, if there is any paragraph of any report that  
21 Mr. Beard wants me to refer to I am very happy to do that. I will hand up the note because  
22 at the start I have summarised certain principles of law, and again, by giving you the  
23 references, I need not take you backwards and forwards to the authorities, unless anybody  
24 wishes me to do so. There are two versions of it. One has got all the material in it,  
25 including confidential material. There are very few paragraphs which are confidential. We  
26 have also, for other people in the room, produced non-confidential versions so that they can  
27 follow it. It seemed to me that this, since it is effectively my speaking note, we could not  
28 keep it from people if they would like to see it. So we have got copies for them. (Same  
29 handed)

30 THE CHAIRMAN: Mr. Green, can I just ask, in relation to the confidential material, if and in so  
31 far as you want to make reference to that, how do you propose to do it?

32 MR. GREEN: I propose simply to ask you to read it to yourselves. I was not proposing to ask  
33 that ----

34 THE CHAIRMAN: So you will give us a reference, yes, all right.

1 MR. GREEN: There are very, very few references in the note.

2 THE CHAIRMAN: So, so far as you are concerned, we can just continue the hearing in open  
3 Tribunal, thank you.

4 MR. GREEN: As a principle, I do not think it is satisfactory that the Tribunal should move into  
5 camera ----

6 THE CHAIRMAN: It is much better if we can avoid that, I agree. Thank you.

7 MR. GREEN: My solicitors, very helpfully, have added a proper index to it. I would like to start  
8 at p.5, which is the key principles of judicial review. The logical starting point would be to  
9 take you to the statute and explain what the Commission's task is. There is nothing  
10 between us on this. The task of the Competition Commission was set out in *Tesco* and in  
11 *Barclays*, and it is relatively straightforward. I can deal with it very briefly, and, unless  
12 anyone wishes me to, I was not going to go to the statute itself. In very broad terms, this is  
13 para.4, the Commission must identify whether a competition problem exists, the adverse  
14 effect on competition or the AEC, they must identify its cause and then they should decide  
15 what steps should be taken or recommended which would be effective in remedying,  
16 mitigating or preventing the AEC. In the present case, between 2009 and 2011 there were  
17 different questions which the Commission had to ask itself, and I think it is important to  
18 have that framework for analysis.

19 In 2009 the cause of the principal AEC was common ownership by BAA of the three  
20 London airports. The cause of the AEC was common ownership of two out of the three,  
21 and that is why the remedy was to break up BAA into its three component parts. One  
22 became three.

23 In 2011 the question is quite different because Gatwick is already in separate ownership, so  
24 you have two competing entities. You have got Gatwick and BAA. The incremental  
25 difference between 2009 and 2011 is moving from one to three to two to three.

26 What benefits did the Commission expect to arise from separate ownership? This is very  
27 much at the heart of ground one. In 2009 the AEC was common ownership, and this was  
28 predicted to hinder the emergence of benefits which would flow from competition but  
29 would arise from three different management teams competing over what was described as  
30 "new capacity". I will take you to the report and explain what the Commission understood  
31 by "new capacity" shortly. In 2011 the equation was very different. The question was not,  
32 do you smash one organisation into three to deal with the new capacity, the question was  
33 now you have got two organisations and separate management and you have got no new  
34 capacity. The sole question in 2011 was whether it was necessary to sever the link between

1 Heathrow and Stansted in order to generate the much reduced benefits which now arise  
2 because there is no new capacity. There were different questions of scale and scope. So the  
3 question in 2011 was simply this: is divestiture of Stansted still an appropriate remedy?  
4 At paras.9 and 10 we refer to the CC's discretion, and then para.11 refers to the four  
5 components of the proportionality test. I would like to take you to those conditions in turn  
6 and make a number of observations about them, because they provide the framework for  
7 analysis.

8 The first condition is very much at the heart of ground one. Ground two is also relevant to  
9 it, but it is very much at the heart of ground one, and it is this: the measure must be  
10 effective to achieve the legitimate aim in question. What is being described here is an  
11 exercise in proving causality between the remedy and the achievement of the aim. The  
12 achievement of the aim are the benefits which divestiture will bring again. Again, the  
13 exercise in 2011 was a very specific one: will divestiture of Stansted bring about the  
14 benefits which the Commission have identified; causal connection between divestiture and  
15 benefits? That is why the words "effective to achieve" are at the heart of condition one.  
16 In order to analyse condition one the Commission must have regard to the legitimate aim in  
17 question, namely the benefits, the benefits of divestiture, but you cannot conduct a proper  
18 analysis of condition one unless you have got a good feel/conducted by a proper analysis of  
19 the extent of that legitimate aim. You have got to have an understanding of its extent and  
20 scope. It may be that you cannot examine it and measure econometrically, quantitatively, in  
21 exact terms, but the case law makes it clear that the Commission must examine it, if not  
22 quantitatively, qualitatively.

23 I would like to make a point about what is meant by "qualitative analysis" now. Qualitative  
24 analysis is everything which is not quantitative. "Quantitative" means "mathematically  
25 precise". Many, many analyses conducted by the Commission will not be quantitative, they  
26 will largely be qualitative, and may involve sensitivity analyses, surveys, all sorts of pieces  
27 of inquiry which generate indicative evidence but do not enable you precisely to quantify  
28 the scope of something. So it is not the case that the Commission must have exact and  
29 precise quantification of the legitimate aim, but it must have a reasonably accurate idea of  
30 its scale and scope.

31 In the present case, the effectiveness of the remedy is a very important issue and let me  
32 explain why at a very early stage so you have it very, very squarely in your minds. As I will  
33 demonstrate shortly, in the 2009 report the Commission examined in chapter 3 what they  
34 described as a "substitutability analysis" of the different airports. They examined to see



1 whether, for example, Stansted and Heathrow exerted a constraint upon each other. That  
2 was a present day analysis conducted in 2009 when there was no future capacity. So they  
3 were looking at a market in which there was a shortage of capacity.

4 A big bone of contention between us and the Commission is that we say the Commission's  
5 own analysis demonstrates pretty unequivocally that there is very limited scope for  
6 competition between Stansted and Heathrow. So that if you divested Stansted, for reasons  
7 unrelated to the divestiture, it would make very little difference to the status quo.

8 There is a lengthy analysis in chapter 3 of why that is so which we say the Commission has  
9 badly misdirected themselves about. The chapter 3 analysis tells you a great deal about the  
10 conditions.

11 MR ALLAN: Are you going to take us to the precise references later?

12 MR. GREEN: Absolutely.

13 MR ALLAN: Thank you.

14 MR. GREEN: I will take you to all of the various paragraphs. Not only have I put it  
15 comprehensively in the note, but I am going to take you to the key paragraphs so you will  
16 have them very clearly in mind. So a major issue there in terms of Condition 1 is: would  
17 divesting Stansted from Heathrow make any difference? Again, because this is a judicial  
18 review we are not putting evidence in front of you. I am relying upon the Commission's  
19 own analysis and own reasoning.

20 There is a second point about effectiveness, which is what I call the *modus operandi* point.  
21 In the 2011 Decision when the Commission addressed itself as to whether divestiture would  
22 be an effective remedy, the vast majority of its analysis concerns whether applying  
23 decapitation would be effective in a technical and mechanical sense. The answer to that is,  
24 frankly, obvious: of course it is. To give you an analogy, to use Lord Diplock's famous  
25 phrase about proportionality: you should not use a sledgehammer to crack a nut if a  
26 nutcracker will do. It is obvious that taking a sledgehammer to crack a nut will crack the  
27 nut; it will pulverise it. It does not tell you anything about whether you should have used a  
28 nutcracker. Most of their analysis about the effectiveness of the remedy is saying: yes, it is  
29 decisive, it is clean, it can be easily monitored, it can be supervised, it sends clear signals to  
30 the market. All of that is absolutely correct, but it tells you nothing about whether it was  
31 justified in the first place. Again, I will take you to those paragraphs in due course. Those  
32 are the observations I make about Condition 1.

33 Condition 2: "The measure must be no more onerous than is required to achieve that aim".

34 The extent to which a measure is onerous is connected to the scale of the benefit. In 2009

1 the Commission's view was that breaking up BAA would generate enormous benefits  
2 (again, I will take you to the text of the decision to show you that), creating three  
3 competitors who would grapple with a truly vast amount of new investment reflective of  
4 new runways and all the attendant facilities at Heathrow and Stansted. Again, I will give  
5 you statistics now which I will probably repeat many times. The Competition Commission  
6 calculated that we were looking at 47 per cent of the existing capacity of the three London  
7 airports, that is what the new capacity would entail. Effectively, one and a half new airports  
8 was the sort of scale which the Competition Commission was contemplating as reflected by  
9 the new capacity which was going to come on stream in due course over 30 years.

10 The benefit of breaking up BAA was, in a sense to the Commission's eyes, pretty obvious.  
11 They did a detailed analysis of those benefits. Therefore, given that the benefits were so  
12 vast, divestiture was not an onerous remedy. It naturally follows that in 2011 the equation  
13 is quite different. You take new capacity out of the equation and you are simply dealing  
14 with the status quo. Even the Commission's own identified benefits are extraordinarily  
15 modest by comparison with the benefits they had in mind in 2009. You then ask: is it  
16 onerous to break up BAA to achieve those very modest benefits? It is a very different  
17 equation and it is an equation we say they have misdirected themselves as to. Of course the  
18 Tribunal will need to form a view about that.

19 But it does mean that under Condition 2 the Commission must have a clear understanding  
20 of the scale of the benefits. As I will make clear, our criticism is that on their own analysis  
21 they have concluded that there is *de minimis* benefit absent new capacity. There is a  
22 mismatch between the words that they used: "substantial, clear", and the actuality contained  
23 in the decision and their prior reasoning.

24 Condition 3: "The measure must be the least onerous if there is a choice of equally effective  
25 measures." In a sense, I think that is an aspect of Condition 2: that it focuses upon this issue  
26 which again the Tribunal will need to grapple with. On the basis of the Commission's own  
27 reasoning and analysis was divestiture the appropriate remedy, or was enhanced or  
28 continued regulation the appropriate remedy? I say that because the Commission's own  
29 analysis of the relationship between regulation and divestiture indicates that regulation is  
30 more effective than divestiture. That is their own findings - not reflected properly in the  
31 2011 decision, indeed not properly analysed at all. That is the upshot of their own  
32 conclusions in 2009.

33 Then finally, Condition 4: "The measure must not in any event produce adverse effects  
34 which are disproportionate to the aim pursued." This focuses upon the cost of the remedy,

1 amongst other things, to the addressee. Here, the cost to BAA. All remedies plainly affect  
2 the addressee. They represent government intervention into freedom of action and freedom  
3 of contract. The economic and the academic literature is replete with studies of the risks of  
4 wrong intervention itself causing harm to the markets, sometimes called “false positives”.  
5 The present case concerns multiple divestitures: Stansted and Gatwick and one of the two  
6 Scottish airports. In overall terms it is not unfair to say that this was just about the largest  
7 individual forced transfer of land since the Reformation. It is for this reason that the  
8 Commission must assess the costs to BAA of its remedy and then conscientiously and  
9 carefully factor that into the proportionality exercise.

10 How would one do that in the present case? In its 2009 and its 2011 Decisions the  
11 Commission explicitly recognised that there are substantial costs to BAA associated with  
12 divestiture - not just the physical costs of separation which they have sought to quantify in  
13 pounds, shillings and pence, but they explicitly recognised there are costs over and above  
14 the physical divestiture costs; they have not quantified them; the costs essentially of forcing  
15 someone to sell major assets into the teeth of a howling financial gale and the risk that there  
16 are depleted proceeds as a result of that.

17 In very broad terms, if you are asking whether or not there is a cost to someone you need to  
18 measure what the economists call a “counterfactual”. In the present case: BAA has the right  
19 not to sell Stansted. If it does decide to sell it, it can pick a point of its own choosing and if  
20 the offer price is not adequate it can, as with all freedom of contract issues, pull the sale. It  
21 has given that freedom up. That is the cost to BAA: valuing that freedom; being told when  
22 to sell and how to sell; having the purchases regulated and governed for you.

23 This issue is dealt with in our ground four and the argument in relation to ground four has  
24 taken an extremely unusual twist in the course of pleadings which I will need to go into in  
25 some detail when I deal with ground four. That is why I am going to deal with ground four  
26 immediately after ground one. It will enable you to see both the costs and the benefits of  
27 the remedy in one go.

28 Going back to the speaking note at para.12 I have identified various ways in which the  
29 Tribunal, and indeed other judges in the Administrative Court, have applied proportionality  
30 to these sort of complex economic questions. There should not really be much dispute  
31 between the parties on these. Paragraph 12: “The Tribunal applies ordinary principles of  
32 judicial review.” We agree with that. Secondly, “The Tribunal has a specialist composition  
33 with members ‘*well qualified to form their own views as to the correct methods of economic*  
34 *analysis*’”, but again applying traditional grounds of judicial review.

1 The proportionality test is not one solely of fact. The issues arising are also matters of  
2 analysis. By that, the Tribunal means inferences to be drawn from facts. That governs such  
3 matters as market definition, identification of the AEC, fashioning of effective remedies,  
4 reasonable and practical remedies, etc. This means, according to the Tribunal, particular  
5 care beyond that necessitated by mere fact finding must be performed, and in *Barclays* the  
6 Tribunal stated there were requirements on the Commission to quantify, evaluate, analyse  
7 causation, analyse sensitivity and analyse risk.

8 Then there was the question of the intensity of the proportionality exercise. There are two  
9 factors which affect intensity. One is the broad ground, well accepted in standard judicial  
10 review, that if you are dealing with an issue of governmental policy at a high level of  
11 abstraction the courts will stand a very long way back from it. You do not interfere with,  
12 for example, decisions as to whether to go to war. That would be a very high level political  
13 decision which would be susceptible to judicial review in extreme circumstances only. At  
14 the other end of the scale are decisions which are heavily based upon a statutory process, a  
15 statutory framework and a statutory analysis, which will entitle the courts to engage in a  
16 more sleeves rolled up exercise. That is the factor: where on the scale of political discretion  
17 does the decision arise?

18 The second factor is the double proportionality point, which comes from *Tesco*. It  
19 effectively says that where you have an intensely intrusive remedy the court will require the  
20 decision maker to engage in a far more detailed analysis. The four factors referred to by the  
21 Tribunal in *Tesco* and *Barclays* are set out in para.14: the importance of the factor in  
22 question being examined in the context of the required analysis, what we say are the four  
23 points we have identified as grounds are at the heart of the conditions and proportionality.  
24 Second, the level of intrusion into the business of the person affected by the  
25 decision/remedy. It should be beyond dispute that this is the most intrusive remedy the  
26 Commission has ever imposed. Then the uncertainty of the effect of the remedy. By  
27 definition, since the Commission is hypothesising as to what might happen in the future, the  
28 effect of the remedy is uncertain and we rely heavily on the Commission's own analysis of  
29 this.

30 Then, fourthly, the extent to which it is wide reaching. This is not a decision about an  
31 individual immigrant who is being turned back at Heathrow, this is a decision as to who can  
32 own Heathrow, Stansted and Gatwick and it concerns the airport access in the south-east of  
33 England. It is an issue of great public importance in terms of the extent to which the  
34 remedy reaches.

1 We submit that those factors lead to the conclusion that the Commission is required to  
2 conduct a detailed review, obviously within limits, but a detailed review, and the Tribunal  
3 holds it to that task. That is what is meant by double proportionality.

4 I have quoted from *Tesco* at the bottom of para.16:

5 “... the more detailed or deeper the investigation of the factor in question may  
6 need to be ...”

7 when one or more of those factors applies.

8 In para.17 we referred simply to standard case law, the requirement to support findings of  
9 fact and analysis with a sufficient evidential underpinning. Many of the cases come from  
10 standard judicial review, some from the Tribunal, some from the Court of Appeal on the  
11 Tribunal’s decision, *IBA*. There is nothing controversial about that.

12 Then paras.19 and 20, classic *Tameside*. Again, nothing controversial. The Commission is  
13 required to address itself to relevant considerations and not take account of irrelevant  
14 considerations. Again, we say that when you look at their own analysis the reasoning is  
15 actually replete with failures of this sort.

16 Then (h), the Commission’s duty to put itself in a position properly to decide the statutory  
17 questions. I have taken you to *Tesco* and to *UniChem*.

18 Materiality: again, nothing magical about this at all. Not every error will lead the Tribunal  
19 to quash the decision, but the Tribunal has given guidance that in judicial reviews, as  
20 opposed to its appeals jurisdiction, there is a limit to which the Tribunal will go and say that  
21 a material point would have made no difference to the outcome or that the same result could  
22 or should be reached by a separate route – in other words, the Tribunal’s guidance on this is  
23 that it will exercise caution in concluding that an error is not material, but again it is a  
24 matter of impression and judgment for the Tribunal at the end of the day.

25 I would like now to simply hand up a document which I am not going to refer to. It is a  
26 document that we handed up in 2009 and we have updated it. It is simply a schedule of the  
27 previous decisions taken by the Competition Commission and the remedies they have  
28 imposed. It simply supports my submission that this is the most draconian remedy ever  
29 imposed.

30 THE CHAIRMAN: Just on that, you keep saying that, but we are now addressing the report in  
31 2011 which is divestiture of Stansted. Divestiture of Gatwick has already taken place.

32 MR. GREEN: That is right.

33 THE CHAIRMAN: So when you say “the most draconian remedy ever imposed”?

34 MR. GREEN: It applies to this report as well as 2009.

1 THE CHAIRMAN: Is Stansted a bigger airport than Gatwick?

2 MR. GREEN: No, I do not think it is as big as Gatwick.

3 THE CHAIRMAN: That is what I was trying to clarify in my mind. One might think that  
4 Gatwick was the most draconian remedy ever imposed.

5 MR. GREEN: The original package was one of the two Scottish airports and Gatwick and  
6 Stansted. Now it is one of the two Scottish airports and Stansted. Certainly 2009 would  
7 have been more draconian than this. This is simply the continuation of 2009, and, I argue, it  
8 is still more draconian than any other decision the Commission has taken to date.

9 MR. BEARD: Sir, just a general point, there is obviously a plethora of new documentation  
10 coming up. I am sure that the speaking note will be invaluable to all of us. Obviously these  
11 documents being provided at the last minute rather does give the Competition Commission  
12 a difficulty in dealing with matters. This one perhaps it will not be. We received another  
13 bundle of documents on Friday. There is no end, of course, to Mr. Green's creativity and  
14 those that have dealt with him in the past know that last minute surprises are always to be  
15 welcomed, but there is a potential difficulty with this sort of material for the Competition  
16 Commission. I think it is proper that the Commission puts down a marker in relation to this  
17 sort of material, and if it needs extra time in order to deal with any submissions that are  
18 based on the new material then I am sure the Tribunal will understand.

19 MR. GREEN: We did supply to the respondent and to Ryanair last week a couple of additional  
20 documents. They are documents which ----

21 THE CHAIRMAN: When last week did you supply them?

22 MR. GREEN: I think they were sent on Thursday. We were asked what the relevance was and  
23 we sent two letters explaining the relevance. One is the transcript of what happened in  
24 2009, which should come as no surprise since they raised various points in their skeleton  
25 which led us to review the transcript. There are some Department of Transport press  
26 releases which it is probably going to take me ten seconds to deal with. There is the  
27 Treasury Green Book, which we accept is not something which binds them, which has  
28 some useful points to make which will take me just a few moments. If my friend wants  
29 time of course he will have time.

30 THE CHAIRMAN: It is not altogether satisfactory if Mr. Beard is having to ask for time when  
31 we have got two, or at best three, days to deal with this. If new material is to be introduced  
32 it has to be done now with maximum notice to the other side.

1 MR. GREEN: There is no further document I am proposing to hand in at all. This document is a  
2 document which was handed up in 2009, we have just simply updated it. It is really  
3 something of precedents, if you like.

4 THE CHAIRMAN: Is it common ground that these precedents are all correct?

5 MR. GREEN: They are simply taken from the public reports.

6 MR. BEARD: Unfortunately, one cannot comment, we have not actually seen them.

7 THE CHAIRMAN: It is not common ground, so have you given us the evidential references?

8 MR. GREEN: They should be there, yes.

9 THE CHAIRMAN: I am just looking, they do not seem to be there. I am just looking at it box by  
10 box, there does not seem to be any evidential reference.

11 MR. GREEN: This was handed in in 2009, it was not controversial then. We would be very  
12 happy to insert some references if it would help them. These are the sorts of things which  
13 are the Commission's own reports, and we rely upon it purely and simply ----

14 THE CHAIRMAN: I do not think I have seen any of these reports. In fact, I know I have not. I  
15 have only read the reports in this case.

16 MR. GREEN: If my friend wishes to say this is not a draconian remedy for the purpose of the  
17 intensity of review he is perfectly entitled to say so. To our minds, it is obvious that there  
18 has not been a case of this magnitude ever before. It is one of the most extreme cases they  
19 have ever taken. It is their case law.

20 THE CHAIRMAN: At all events, where do you want us to put this document?

21 MR. GREEN: There is a file which you should have, which is of additional material, which has  
22 got some additional leaves in it. Perhaps you could insert it in there.

23 THE CHAIRMAN: So tab 6. I have done that. You will tell us when you want us to go to it.

24 MR. GREEN: Certainly, yes.

25 I am now going to turn to ground one. The submission of BAA in relation to ground one is  
26 that the Commission, in failing to conduct a new investigation, has, in essence, failed to put  
27 itself into a position whereby it was able or entitled to take proper decisions about the  
28 divestiture remedy and answer the statutory questions.

29 In 2011 the Commission articulated a very high degree of confidence in its own findings  
30 and conclusion. As you will have seen, indeed repeated often in its skeleton and defence,  
31 they say that its conclusions in 2009 stand and they justify exactly the same remedy now as  
32 they did then. They have explained that in their view they conducted a detailed analysis of  
33 the benefits to competition of divestiture absent new capacity. They say they found the  
34 benefits were, and I use their word, "intense". They keep on relying upon that.

1 In para.12 of the 2011 decision, which is at bundle A, tab 2, they provide a quick and easy  
2 summary of their conclusion and I would like to highlight certain features of it. This is a  
3 typical paragraph that sounds plausible when you read it on the first occasion, but then,  
4 when one picks away at the logic, it begins to crumble. Paragraph 12 says:

5 “As to whether that remedy remains appropriate and proportionate, we have re-  
6 assessed the benefits ...”

7 Point one is that they have conducted a re-assessment of the benefits –

8 “... of that remedy relative to its costs ...”

9 They say they have taken account of the current lack of support for new runway capacity.

10 “We have found that the benefits of the divestiture remedy are still likely  
11 substantially to outweigh the relevant one-off cost of divestment, and the impact  
12 on BAA’s business.”

13 Can you please note the word “substantially”, which is their conclusion about their own  
14 prior findings; and can you please note that they are balancing the “substantial benefits”  
15 against (a) the relevant one off costs of divestment, and (b) the impact on BAA’s business.

16 Then they say:

17 “In other words, even if no new runways were built in south-east England, over  
18 the long term the requirement that BAA divest itself of Stansted would still be  
19 justified. In coming to this conclusion, we have had regard to the scale of the  
20 airport infrastructure and operations involved, and the fact that, while the costs  
21 of divestment will be incurred only once, the benefits are likely to be developed  
22 and sustained for at least 30 years.”

23 So could you please note that they are adopting a 30 year analysis, and I will make the point  
24 now that they have never conducted an analysis of the benefits of divestiture absent capacity  
25 beyond 2017. Thirty years goes from 2009 to 2039. In their analysis in the 2009 decision  
26 they explicitly limit their analysis to the point in time at which the first new runway might  
27 be built, which they state is 2017. I will deal with that when I deal with the duration of the  
28 so-called benefits.

29 In Appendix A to this same decision at para.80 – again I will come back to this when I  
30 analyse why they say they did not need to conduct a new analysis. Under the heading  
31 “Quantifying the benefits of divestiture”, they say their analysis has been qualitative.

32 “In the 2009 report, we said that we did not quantify the benefits of the  
33 divestment of Stansted and Gatwick given the complex interactions of the  
34 London airports and the existing regulatory regime... In our provisional



1 consideration we concluded we did not need to try and conduct such an exercise  
2 now as, in our view, for the reasons set out above, we believe [it is clear and  
3 obvious that you do not need to conduct an investigation] it is clear the benefits  
4 of divestment significantly outweigh the costs.”

5 So the reason for not conducting an analysis is because it is obvious. That is their  
6 conclusion about scale - clear.

7 “We also noted that as well as having limited scope for useful outputs,  
8 attempting to quantify the benefits of divestment of Stansted would be a very  
9 resource-intensive exercise.”

10 That is, with great respect, a wholly unacceptable justification. It is not one we need to rely  
11 upon. If you are the Competition Commission you cannot simply say it is going to be  
12 resource intensive therefore we will not do it. It is their job; it is what they do.

13 In para.76 of the same Appendix A, which is where proportionality is measured, under the  
14 heading “Summary of Likely Areas of Benefit Beginning in the Near Future”: “In  
15 summary, we consider that there are many sources of long-term benefit...”. The keys  
16 words are “many sources of long-term benefit”. I will show you there just are none; it is  
17 just not true. “Likely to begin in the near future from the divestiture of Stansted even in the  
18 absence of any new runway development. Service quality improvements...” Again, I will  
19 show you that on their own analysis they conclude that service quality improvements are  
20 unlikely to arise. “Capital cost efficiency savings...” They refer to that for the first time in  
21 2011 but they never considered it to be even remotely relevant in 2009. “Operating cost  
22 efficiency savings...” - ditto. “Price competition...” They admit that price competition at  
23 best is modest. They then describe these as “significant sources of benefits” likely to be  
24 developed and sustained for at least 30 years. Again, I will simply do no more than hold up  
25 their own reasoning against their conclusion, their extreme conclusions.

26 So we have now got that they conducted a detailed analysis, there were substantial benefits,  
27 there were many of them, they were significant, they are long-term and they are clear and  
28 decisive. These adjectives, these descriptors, they describe the level of investigation, the  
29 quantum of the benefits, and the extent to which the benefits outweigh the costs.

30 I would like to show you now in the same report para.112, tracking back to the main part of  
31 the 2011 Decision, paras. 112, 113, and 115.

32 At para.112 the Commission says: “The change in government policy changes the  
33 prospects for new runway capacity coming on stream in the foreseeable future. It does not  
34 change the scope for competition between airports in the absence of new runway capacity.”

1 With respect, that statement is utterly bonkers in relation to their own analysis in the 2009  
2 report! In fact, the two analyses could not be more different. Again, you will have to form  
3 a view about this. For them to say that it makes no difference to the analysis for  
4 competition between the airports with and without capacity is the precise opposite of what  
5 they found in 2009.

6 “In our 2009 report we made clear that the timing and likelihood of new runway  
7 capacity was uncertain. We therefore considered in some detail in the 2009 report  
8 the scope for competition within existing capacity constraints. As we do not find,  
9 in our analysis of other suggested MCC’s, any significant changes relating to  
10 competition absent new capacity, in our judgment we do not need to undertake a  
11 completely new assessment of the scope for competition between Heathrow and  
12 Stansted set out in the 2009 report.”

13 Then they use the word “detailed”.

14 “The detailed assessment conducted in 2009 (see Appendix 5.1...) in our view  
15 remains the appropriate analysis of the scope for competition in the absence of new  
16 runway capacity.”

17 What that means is that you will need to look closely at what they did say at Appendix 5.1  
18 because this is where they say they conducted the “detailed assessment”. What you will see  
19 is that the assessment was not detailed at all but what it did do was identify reasons why in  
20 fact the benefits were not likely to come about. They identified all sorts of obstacles in the  
21 realisation of price, service quality benefits. They certainly did not say for a moment that  
22 they would come about, or that they were substantial. There is no criticism made by us of  
23 that analysis whatsoever because in 2009 it was not needed; it was a peripheral part of their  
24 overall view. Their conclusion was predicated upon new capacity coming into the market,  
25 they were confident of that conclusion and that would bring forth and unleash an absolute  
26 torrent of competition with huge benefits. It did not think that the government would  
27 reverse its policy, so they conducted a very thin analysis of benefits without capacity and  
28 there was no need for them to go very far down the analytical line at all. It was not  
29 necessary.

30 Again, you may disagree with me. You will have to form a view about the analysis that  
31 they did and did not undertake in 2009 and why. Then you have in para.113 conclusions on  
32 the benefits and scope for competition absent new runway capacity.

33 “In the 2009 report we found that competition to invest and innovate, even in the short  
34 term, could be intense.” We strongly object to that sentence. They did not so find. I will

1 take you to the paragraphs in due course, but let me tell you what the point is. In 2009 in  
2 Appendix 5.1 the Competition Commission commented upon some observations made by  
3 the Civil Aviation Authority. The CAA was talking about competition with the prospect of  
4 new capacity coming on stream. It was not making an observation about competition  
5 absent new capacity. Indeed, in their defence at para.40 the Commission acknowledge this.  
6 A clear misdirection. The new team that examined the 2011 Decision re-read incorrectly  
7 the 2009 Decision.

8 THE CHAIRMAN: Can we just look at that.

9 MR. GREEN: Certainly. Bundle C about two-thirds of the way through. This is the 2009  
10 report.

11 THE CHAIRMAN: Sorry, I just wanted to check the reference in their defence.

12 MR. GREEN: I am sorry, bundle E, Sir.

13 THE CHAIRMAN: Mine does not have a number on it. I think I have got it 6 and we are going  
14 to call it bundle E. Is that right?

15 MR. GREEN: It is p.18 of the skeleton.

16 THE CHAIRMAN: Let us take it in order. Paragraph 40 of the defence. Let us do that first.

17 MR. GREEN: About two-thirds of the way down you will see --

18 THE CHAIRMAN: Let us just read it for ourselves. (Pause)

19 MR. GREEN: In particular those words "were not confined to".

20 THE CHAIRMAN: I am still reading. Just a moment. (Pause) I am sorry, I am just trying to  
21 follow this. What are the paragraphs 3 and 4 that are referred to?

22 MR. GREEN: Look at bundle C. Really you need the two open together. If you go to  
23 Appendix 5.1 about two thirds of the way through that bundle.

24 THE CHAIRMAN: I see, so paragraphs 3 and 4 there reconcile to paragraphs 3 and 4 in  
25 Appendix 5.1?

26 MR. GREEN: That is right. (Pause) If you look at para.3 the Competition Commission here is  
27 referring to the CAA's evidence:

28 "The CAA , on the other hand, told us that the combination of capacity constraints  
29 and regulation would not necessarily or materially limit the scope for additional  
30 competition between BAA's London airports."

31 I pause there. When they refer to "capacity constraints" you need to have clear in your  
32 mind two different things. Before the point in time in which a new runway was built, which  
33 they posited was 2017, you would have capacity constraints but you would have  
34 contemplated new capacity. One of the big points the Commission makes is for pre-

1       emptive competition: during that period from 2009 to 2017 airlines, everybody, would be  
2       taking decisions in anticipation of new capacity. Then, of course, you have got the premise  
3       which was at the heart of the 2011 decision: no new capacity at all - contemplated or  
4       otherwise. It is clear here the CAA is referring to a mixture of future and existing capacity  
5       constraints but concluding that which is simply *pro tem* pending new runways. For  
6       example:

- 7               “(a) price terms of access (including the duration of the contract, the charging  
8               structure, the allocation of risks of volume downturns etc);  
9               (b) the nature of the airport and/or commercial services (which may be redefined,  
10              bundled or unbundled in different ways to suit different airline or passenger  
11              requirements);  
12              (c) the quality of service, whether in terms of ambience or efficiency of operation  
13              (eg minimizing delays);  
14              (d) investment in facilities, including ways to improve or increase terminal, or  
15              other, capacity, which may have relatively short lead times; and  
16              (e) other innovations, which neither the CAA - nor any other regulatory or  
17              competition authority - could reasonably be expected to predict.”

18       All of those reflect the analyses conducted by the CAA and the Competition Commission in  
19       anticipation of new capacity. Then you see the reference “or other capacity” in 3(d).

20       “4. We agree with the CAA that competition to invest and innovate, even in the short term,  
21       could be intense.” It was plain to us that they were not just referring to a market without  
22       capacity at all, but that is why in their defence they say that investment in innovation was  
23       not confined to new runway capacity. In other words it includes it but is not confined to it.  
24       In fact, there is very little capital investment which the Commission identifies in the  
25       absence of new capacity. It is small.

26       MR ALLAN: Can I just be clear what you are saying, Mr. Green. Are you saying that the factors  
27       identified in para.3 are contingent upon new runway capacity and that the CAA would not  
28       have identified those as potential --

29       MR. GREEN: Some are, some are not. It is unclear how you untangle them. That is the point we  
30       made in the next paragraph: how do you untangle prospective capacity from a market where  
31       there is absolutely no capacity? But they certainly refer to “capacity”, and the Commission  
32       in its defence makes the point that the investment in innovation was not confined to new  
33       runway capacity. In other words, it includes it.

1 Indeed, the point is vacuous because if these had been benefits, then when the Commission  
2 goes on to explain what the individual benefits are they would have taken each one of these,  
3 but they did not. None of these points are developed in Appendix 5.1. A very small  
4 number of points are actually developed, and the points that they do develop are those  
5 which they say explicitly in their report they also rely upon. They do not, in the 2009  
6 report, rely upon any of these at all as benefits absent new capacity. I will take you to the  
7 paragraphs.

8 THE CHAIRMAN: Do we have the CAA's evidence? Does that make it clear what they were  
9 talking about?

10 MR. GREEN: It is not in the bundles. There is a mountain of evidence put to the Commission.  
11 We can certainly dig it out if it will be of assistance.

12 THE CHAIRMAN: Given the emphasis that you are placing upon this, this is purporting to  
13 summarise evidence from the CAA.

14 MR. GREEN: In fact, it is a relatively small point. It is a point which is symptomatic of the fact  
15 that they use these terms. If you would like it, we can certainly dig it out but once you have  
16 seen the analysis of the 2009 report.

17 THE CHAIRMAN: Right. But you are making a very specific criticism of the 2011 report  
18 misstating or misunderstanding what was said before, but in order to understand what was  
19 said before do we not need to see whether they have misunderstood what was said before,  
20 which was a summary of what the CAA was saying?

21 MR. GREEN: We can certainly do that. Can I respectfully suggest we park the issue as to  
22 whether you want to do that for a while, because once we have looked at the 2009 report it  
23 is very plain what they did consider to be relevant and what they did not consider to be  
24 relevant. They are very clear that in relation to ----

25 THE CHAIRMAN: Do we understand that you are not pressing your criticism of the description  
26 of the competition as "intense" in the absence of new runway capacity, but if you are going  
27 to press it you will come back to us and explain ----

28 MR. GREEN: I am just simply relying upon their acceptance in para.40 that it covered both.  
29 That is why the words "was not confined to new runway capacity" are significant. They  
30 accept the CAA submissions covered both in the last two sentences. That investment and  
31 innovation, that is what is being referred to in 3(d):

32 "investment in facilities, including ways to improve or increase terminal, or  
33 other, capacity ..."

1 So that investment was not confined to new runway capacity. That was our understanding  
2 of the CAA's evidence. It was a generalised submission about the benefit of new capacity –  
3 of capacity and what might happen prior to new capacity.

4 THE CHAIRMAN: In (d) they seem to be talking about other forms of capacity than runway  
5 capacity.

6 MR. GREEN: It was not confined to new runway capacity. In other words, that is within the  
7 category but not limited to it. That is why they used the words “was not confined to new  
8 runway capacity”.

9 THE CHAIRMAN: I am just now looking at para.3 in Appendix 5.1, “The CAA, on the other  
10 hand, told us that the combination of capacity constraints and regulation”, I think you were  
11 indicating there that “capacity constraints” is runway capacity constraints.

12 MR. GREEN: Yes, it is essentially runway capacity constraints.

13 THE CHAIRMAN: “... would not necessarily or materially limit the scope for additional  
14 competition, in particular there could be competition”. So the way para.3 reads is, let us  
15 assume that capacity constraints continue, there can still be competition in relation to these  
16 other matters, and if that is the right way to read it, then in (d), when they talk about  
17 “terminal or other capacity”, they are talking about capacities within the undertakings  
18 themselves of the airports, other than runway capacity?

19 MR. GREEN: As they explained in 2009 – and this is why, in a sense, once we have gone  
20 through 2009 this probably becomes clear – they have this notion of pre-emptive  
21 competition, they say that, “As you are anticipating new runway capacity, you will take a  
22 range of decisions related to new runway capacity” – for example, tender processes, design  
23 processes – “all of which will impact directly on the runway capacity in anticipation of it,  
24 and competition will therefore be triggered in relation to capacity very quickly”. That is a  
25 point they say is a key point to their analysis.

26 THE CHAIRMAN: I do follow the idea of pre-emptive competition against the backdrop that  
27 everyone thinks a new runway is coming. My difficulty at the moment is in reading para.3  
28 of Appendix 5.1 in that way.

29 MR. GREEN: Look at para.24 where you see ----

30 THE CHAIRMAN: Can we look at para.3, that is what I am having difficulty with?

31 MR. GREEN: This reminds you of the context of para.3.

32 THE CHAIRMAN: All right, para.24 of Appendix 5.1

33 MR. GREEN: In this appendix. This provides their conclusion as to what the benefits are, absent  
34 new capacity. This is repeated time and time again in 2009. They identified two things and

1 two things only: service quality and price. That is all they have ever identified anywhere in  
2 these reports as being the progeny of competition flowing from divestiture of Stansted  
3 absent new capacity. When you analyse them they have never ever said that anything other  
4 than these two flow from their Appendix 5.1 analysis.

5 THE CHAIRMAN: So does one read para.24 as meaning, “In the presence of capacity  
6 constraints, i.e. even if one leaves out an expectation that new runway capacity is coming on  
7 line, there will be these benefits”?

8 MR. GREEN: Yes.

9 THE CHAIRMAN: Right. If you read it that way there, do you not read para.3 in the same way?

10 MR. GREEN: No, we have got two criticisms of Appendix 5.1. One is it is very time  
11 constrained. They are only looking at benefits up to new runways. Secondly, they have  
12 intermingled capacity and non-capacity constraints. That is what the CAA was effectively  
13 saying. They may have misread it. That is what they have admitted to in para.40.

14 THE CHAIRMAN: I have to say that I do not read para.40 of the defence as an admission that  
15 they have misread para.3 of their report. I just do not read it that way. If we look at para.3  
16 you need to establish that para.3 means one thing and they have misread that.

17 MR. GREEN: Can I park it for a while, because I think it will become clear?

18 THE CHAIRMAN: When you say “I will park something”, that means I will not treat it as a  
19 submission being pursued unless you come back to it.

20 MR. GREEN: Absolutely, and I will come back to it. It will make more sense when we have  
21 looked at the 2009 report and we will check the CAA underlying documents, because I am  
22 pretty confident I am right.

23 THE CHAIRMAN: Just on para.3 now, since we are there and you have shown me para.24, why  
24 should one not read Appendix 5.1 as a whole? And where, as you have just accepted, in  
25 para.24 the Competition Commission is talking about the presence of capacity constraints,  
26 they are ruling out both: there are not additional runways there now, but they are also ruling  
27 out there is not an expectation that additional runways will be there. That is what you have  
28 just told me it meant in 24. Why does not one read para.3 in the same way?

29 MR. GREEN: Because it is not factually correct. Let me assume that you are right ----

30 THE CHAIRMAN: Sorry, when you say “it is not factually correct”?

31 MR. GREEN: We will check it, but we have looked at this, and I will need to get them out again  
32 and review them because it is some time since I looked at them. My recollection is that  
33 they refer to a mixture of different types of market assumptions.

1 If you assume that you are correct, you get the analysis of the scope of service and price in  
2 the following paragraphs, and that actually tells you what the CC thinks about the scope for  
3 competition. You can then form a view as to whether you think, on their own analysis, it  
4 could ever be intense. Our submission is, not in a million years.

5 THE CHAIRMAN: All right. Let us leave it for now, but I am still concerned about the reading  
6 that you are pressing on us for para.3, but by all means come back to it if you want to  
7 persuade us more on that.

8 MR. GREEN: Within the same defence, the only other paragraph I would like to show to you  
9 which really sets out the Commission's position, before we compare and contrast that with  
10 their own prior analysis, is para.43 of the defence. Paragraph 43 is an easy one to grapple  
11 with because the correctness of this paragraph rests upon its own prior analysis. It says:

12 "As set out in Appendix 10.1 ..."

13 - and that concerns the reasons why the Commission felt it had to divest Stansted over and  
14 above Gatwick, amongst other things –

15 "... Heathrow was the second closest substitute for Stansted, and Stansted was  
16 the second closest substitute for Heathrow (in both cases after Gatwick)."

17 It is common ground between us that Gatwick is the strongest competitor to Heathrow and  
18 to Stansted.

19 "The CC explained that, whilst Gatwick was found to be the closest substitute  
20 for Heathrow, Stansted remained an important alternative to Heathrow ..."

21 You might want to underline that, because we submit it is not what they found. They found  
22 pretty much the opposite.

23 "... and that the data on substitutability ..."

24 Again, we say, which data, because the only data that there is in the 2009 report does not  
25 show that Stansted and Heathrow could impose an important constraint on one another.

26 Again, a very important point arises here. I will explain it briefly. They assume that there  
27 is symmetrical pressure – Heathrow on Stansted, Stansted on Heathrow. In fact, the  
28 chapter 3 analysis showed that Stansted had very little ability to constrain Heathrow at all  
29 for two reasons: first, Heathrow was unique in terms of its infrastructure as an international  
30 hub, and it meant that airlines in response to, let us say, better prices at Stansted simply  
31 would not leave; and secondly, because Stansted was substantially capacity constrained,  
32 both airports were capacity constrained, there was little ability for airlines to move. What  
33 the Commission actually found was a degree of asymmetrical constraint. They said  
34 Heathrow has the potential to constrain Stansted, but when they went on to examine that



1 potential they found it to be very limited, but they do not say that Stansted can constrain  
2 Heathrow.

3 You will form your own view about whether that is correct or not by reading chapter 3, and  
4 I will take you to the relevant paragraphs. We submit that that is just not a correct reading  
5 of their own prior analysis.

6 What I am going to do now is take you to the Commission's own reasoning. You have got  
7 the Commission's position. The next thing is their reasoning and I am going to do it in this  
8 order. I am going to start with chapters 3 and 5, which do concern the extent to which the  
9 airports constrain each other. That is critical because if you assume that Stansted is divested  
10 one has to ask the question, "What impact would that have on Heathrow?" It is irrelevant  
11 what impact it has on Gatwick because that relationship already exists. We are only  
12 concerned with its impact on Heathrow. Substitutability, or this constraint analysis, is  
13 governed by chapters 3 and 5 of the report.

14 I am then going to take you to the Commission's reasons for why they divested Stansted last  
15 time, and you will see that it is almost exclusively, predominantly, overwhelmingly, based  
16 upon an assumption of new capacity. You cannot fairly read those paragraphs and assume  
17 that they would ever have ordered the divestiture of Stansted absent new capacity. Again,  
18 that just flows from their own prior logic.

19 Then I will come back to Appendix 5.1 and show you what their analysis was as to what  
20 was left – competition absent new capacity.

21 Then I will show you the equivalent in the 2011 report.

22 THE CHAIRMAN: Mr. Green, I have been told we need to give the shorthand writers a break.

23 Now is probably as good a time as any. 11.45 will be the time we will aim for, it seems a  
24 natural break. We will rise now for five minutes.

25 (Short break)

26 THE CHAIRMAN: Yes, Mr. Green.

27 MR. GREEN: All I have done so far is to set out the target: what is it the Commission says about  
28 its own analysis? Now I am going to show you the analysis. There are three main chunks  
29 of submission. First I am going to take you to the speaking note so you have the points in  
30 mind. Then I am going to take you to chapter 3 to show you the individual paragraphs  
31 which are relevant, then chapter 5, interspersed with part of 10.1, so you have what it  
32 actually says as well as the submission, so you can see the actual evidence.

33 I would like to pick up the speaking note at para.27. The reason why it is necessary to  
34 assess the importance of competition based on capacity is because it is that which is now

1 missing and it is that which is reflected in the material change of circumstance. In order to  
2 gauge its importance one needs to see how the Competition Commission itself analysed that  
3 component. That tells you how big a material change of circumstance it is. In our  
4 submission, the 2009 decision was overwhelmingly predicated on an assumption that new  
5 capacity would come into the market and this would be over a 30 year period. I am going to  
6 just read from the submission and then I will quote from my speaking note.

7 The Commission devoted a substantial part of the 2009 Report to the development of airport  
8 capacity. This was a critical issue because the Commission concluded that the degree of  
9 competition is "... generally between airports with spare capacity or capacity that can  
10 readily be expanded".

11 The Commission also concluded that:

12 "... lack of capacity, particularly runway capacity, at the south-east airports not  
13 only has an effect on the scope for potential competition between any separately-  
14 owned airports, but is also a main reason for the current poor standards of service  
15 at the airports and lack of resilience at times of disruption."

16 In chapter 5 of the 2009 Report, the Commission considered the degree of competition that  
17 existed between airports. The starting point was that the situation in the South East was  
18 different to that as between BAA's Scottish airports. The Commission acknowledged that:

19 "... the assessment for the South East is affected by the presence of capacity  
20 shortages and formal price control at BAA's three London airports."

21 At paragraph 5.9 the Commission stated:

22 "As discussed in Section 4, in recent years BAA's London Airports have operated  
23 at or close to runway capacity for at least some periods of the day and year.  
24 Heathrow has experienced excess demand throughout the day and year; Gatwick  
25 has experienced excess demand through much of the day in summer; and at  
26 Stansted demand has been at or very close to capacity at peak times of the day in  
27 the summer (though Stansted demand has been declining for two years and initial  
28 indications for summer 2009 are that some runway capacity will be available  
29 throughout the day). As discussed in Appendix 3.1 the tight capacity in the  
30 London area in recent years make it more difficult for airlines to switch between  
31 airports and therefore affects the potential for airport competition (particularly as  
32 there has not been the opportunity for airlines to agree long-term contracts when  
33 capacity was added)."

34 The Commission linked capacity constraints to the continuation of price regulation:

1 “In the absence of common ownership and capacity constraints, the market  
2 position at least of Gatwick and Stansted would, in our judgment not be such as to  
3 require price caps (see paragraph 5.8). We consider that price caps on Gatwick  
4 and Stansted are a direct and indirect effect of common ownership (they are a  
5 direct effect due to common ownership of the closest substitute airports and an  
6 indirect effect due to the effect of common ownership on capacity).”

7 In para.5.12 the Commission summarised its position in relation to the potential for  
8 competition between BAA airports within existing constraints. I wonder if I could ask you  
9 to look at 5.12, but so you have 5.11 in mind as well at the same time. I think Mr. Beard  
10 would like you to see 11 and 12 together.

11 THE CHAIRMAN: We will read those two paragraphs to ourselves.

12 MR. GREEN: Thank you. (Pause)

13 THE CHAIRMAN: Just after 5.11 that does seem to involve an assessment by the Commission  
14 that there will be competitive effects on Heathrow reflected back from competition from  
15 Stansted.

16 MR. GREEN: They talk about “when necessary” and it is conditional. But I am happy for you to  
17 draw that conclusion because --

18 THE CHAIRMAN: Sorry, I was just focusing on the sentence: “Furthermore, we consider that  
19 competition from each of the other two airports would have had an impact on Heathrow.”  
20 You were saying before that their findings simply supported an asymmetry of competitive  
21 effects Heathrow on to Stansted but not the other way round.

22 MR. GREEN: These are not absolutes, as I am sure you appreciate. One cannot say there is  
23 absolutely no impact at all. The question is: is it a substantial impact or is it a very minor  
24 impact?

25 THE CHAIRMAN: Right. So when you said that their assessment only showed that there is an  
26 asymmetry of competitive effects, that needs to be modified as a submission, does it?

27 MR. GREEN: Sir, if I conveyed the impression I was talking in absolutes, I am not. These things  
28 are never absolute. One is asking oneself does the Commission consider there is a material  
29 impact of one on the other?

30 THE CHAIRMAN: Yes, I just noted your submission that the Commission only held that there is  
31 an asymmetry of effect, but you are saying they did not only find it, but most of the effect is  
32 asymmetrical. Is that right?

33 MR. GREEN: Again, you will judge for yourself when I show you the paragraphs. The effect  
34 they described as “weak” one way and they said there was potential --

1 THE CHAIRMAN: It may be a minor textual point, but they seem to be saying in terms that  
2 there is a competitive effect from Stansted on to Heathrow.

3 MR. GREEN: They do cite an example which I will take you to.

4 THE CHAIRMAN: I just wanted to explore the submission that you just made to us. You  
5 seemed to be saying it was only an asymmetrical effect.

6 MR. GREEN: I am not saying anything is absolute in this, nothing is absolute. But it is  
7 asymmetrical according to their own findings. They do conclude that the impact that  
8 Stansted can have on Heathrow is very limited but there is a greater impact the other way  
9 round. But this is simply a summary of what you find in chapter 3.

10 MR. BEARD: Can I just assist the Tribunal. In order to understand 5.11 actually starting at 5.10  
11 might be helpful. I am slightly loath to introduce more reading.

12 THE CHAIRMAN: All right, we will read 5.10 as well. (Pause)

13 MR. GREEN: I am not certain that it helps. What it is talking about is the Competition  
14 Commission's criticism that in the past common ownership had prevented new capacity  
15 coming on stream. There is a whole chapter which refers to this, chapter 4. They conclude  
16 that in the past there have been fewer incentives to lobby and promote new capacity. But  
17 para.5.10(b) "in the absence of common ownership and capacity constraints, the market  
18 position at least of Gatwick and Stansted would, in our judgement, not be such as to require  
19 price caps." So if there is new capacity coming forward in the future then the Commission  
20 concludes that in relation to those two airports they could reduce or limit the scope of  
21 regulation. That is what they are saying. It is in the absence of capacity constraint, ie with  
22 new capacity, competition will do away with the need for regulation.

23 THE CHAIRMAN: Then we will read 5.12.

24 MR. GREEN: Yes. I think all you need to note about 5.12 is it is really a summary of what is  
25 contained in Appendix 5.1 which we will come to in due course. (Pause)

26 THE CHAIRMAN: In 5.12 when they talk about "within existing constraints" is that to be read  
27 as leaving out of account the anticipation of future runway capacity?

28 MR. GREEN: The difficulty with that is when you look at Appendix 5.1 they measure the benefit  
29 up until the point in time in which capacity comes on stream. That is their basic  
30 assumption.

31 THE CHAIRMAN: Right. I am just asking for your submission on how we read this. What is  
32 being pointed out to me is the last part of 5.12 says "Even within existing constraints we see  
33 scope for some competition though the intensity of price competition would be modest"  
34 which I think you rely on in the current position.

1 MR. GREEN: Yes.

2 THE CHAIRMAN: That suggests that when they are talking about “within existing constraints”  
3 in para.5.12 they are talking about a world where one does not now have additional runway  
4 capacity and there is not an expectation of additional runway capacity.

5 MR. GREEN: Yes. It does not actually much matter to our analysis whether Appendix 5.1  
6 assumes future capacity or not. In a sense, I have to take a more conservative basis.  
7 Assume that they are right and that Appendix 5.1 assumes no new capacity ever.

8 THE CHAIRMAN: And no-one is making the prediction of future capacity.

9 MR. GREEN: No, even though they stopped their analysis in 2017, which is the oddity about it.  
10 The hypothesis in Appendix 5.1 should be: how would non capacity related benefits flow  
11 over 30 years, but they only measure it up until new runway capacity.

12 THE CHAIRMAN: I just want to understand your submission. Certainly it seems to clear the  
13 ground, if you are accepting that para.5.12 and Appendix 5.1 are intended to address a  
14 situation where there is no current new capacity and no expectation of capacity --

15 MR. GREEN: I am going to operate on that basis for the purpose of analysis because it is a more  
16 conservative basis and, as I say, it does not matter to our analysis.

17 THE CHAIRMAN: But I do need to know whether you are making that submission.

18 MR. GREEN: I am going to check the CAA submissions.

19 THE CHAIRMAN: All right. So do we leave it on the basis that for the moment the argument  
20 proceeds on the footing that 5.12 and Appendix 5.1 should be read --

21 MR. GREEN: That is the way we will proceed for the time being.

22 THE CHAIRMAN: And you will come back to us and tell us if there is a difference?

23 MR. GREEN: Yes.

24 MR. ALLAN: You will accept that you leaving it there for the time being and if you do come  
25 back to us, it would be helpful to have in mind the last parenthetical sentence in 5.12 and  
26 5.15 which do seem to suggest that there is a distinction being made between existing  
27 capacity competition in Appendix 5.1 and pre-emptive --

28 MR. GREEN: I understand that and I accept that. The oddity is that if that were true there is no  
29 explanation for why they stopped their temporal analysis at 2017.

30 MR. ALLAN: But that is a separate point you are going to come back to.

31 THE CHAIRMAN: Very well, I think that is clear enough that unless you tell us differently we  
32 will read 5.12 and Appendix 5.1 as premised on the basis of no expectation of additional  
33 capacity, which I rather think is what Mr. Beard will invite us to read. All right, thank you.

1 MR. GREEN: That is what he is inviting you to do. What I am going to do now is just - I have  
2 done it in the speaking note from para.36 onwards and I will cross refer you to the various  
3 paragraphs - to identify the various ways in which the Commission concluded that  
4 divestiture would be beneficial because it would generate competition in a number of  
5 different ways, all of which relate to new capacity. There are some 15 cross references. We  
6 have simply tried to pick out the ways in which competition could thrive in the context of  
7 new capacity.

8 THE CHAIRMAN: Sorry, in the context of an expectation of new capacity, is that?

9 MR. GREEN: Yes.

10 THE CHAIRMAN: The reason that you are going through this is what?

11 MR. GREEN: Because it will lead to the conclusion in my ultimate submission - it is impossible  
12 to put it in percentage terms – that overwhelmingly, predominantly, every decision taken in  
13 2009 was predicated on new capacity and not competition absent new capacity. That  
14 enables you to judge the correctness of their assertion and submission in 2011 that this  
15 analysis simply holds true and you can rely upon this analysis and say it is relevant now.  
16 We say that the material change in circumstances was so fundamentally material that it  
17 actually undermines every conclusion that they have arrived at in 2011.

18 THE CHAIRMAN: Forgive me, just on that, arising out of our discussion about 5.12 and  
19 Appendix 5.1, the shift would not undermine what they say in 5.12 and in Appendix 5.1 for  
20 the reasons that we have just debated? You just helpfully clarified for us that you do not at  
21 the moment invite us to read 5.12 in Appendix 5.1 as predicated other than on an  
22 assumption that there is no current new capacity and no expectation of new capacity.

23 MR. GREEN: That is right, that is our principal submission. That is, in a sense, whether  
24 Appendix 5.1 intermingles assumptions does not really matter to our submission.

25 THE CHAIRMAN: You were just saying that there is nothing in the 2009 report which is not  
26 based on an assumption of new capacity, and I was just putting to you that it ----

27 MR. GREEN: No, I said “predominantly, overwhelmingly”. I am not saying that they did not  
28 consider competition absent new capacity. I will be more careful with my words. I am not  
29 talking as an absolute. I am saying the overwhelming reason, predominantly, the decisions  
30 were justified on an assumption of new capacity. Yes, I absolutely accept there was some  
31 analysis of competition absent new capacity, but in terms of relative scale it was peripheral  
32 and unimportant to their conclusion.

33 THE CHAIRMAN: All right, thank you.

1 MR. GREEN: When, in 2011, they say that everything in 2009 holds true, we conducted a  
2 detailed analysis, we think that is not an inference they can properly draw from their own  
3 2009 conclusion. I absolutely accept they do examine competition absent new capacity, but  
4 the scale of it, the extent of the analysis was, we say, incomplete. They did not have to do  
5 very much because it was not really relevant to their thinking. It is not a proper finding  
6 which they can rely upon simply to do no further work in 2011. It is the same sort of  
7 argument which succeeded in *UniChem*, in *Tesco*, in *Barclays*. They have some analysis  
8 but it just does not go far enough. It is an insufficient platform for their 2011 decision.

9 THE CHAIRMAN: Yes, thank you.

10 MR. GREEN: We have set out in para.36 the different ways in which competition could benefit  
11 the market with new capacity. The scale of the new capacity was huge. The Commission  
12 says it was 47 per cent of existing runway capacity. With new runways, of course, airports  
13 must build and invest in support infrastructure. New runways mean more flights in and out,  
14 they mean larger, better or even new terminals, that means car parks, roadworks in and out  
15 of the airport, it means new terminal facilities, everything from retail facilities right the way  
16 through to toilets. With a building and construction agenda of this scale, three competing  
17 management teams will compete to secure first mover advantages. The first management  
18 team to get the new runway operational may use that to entice in new airlines. The  
19 Commission found that there will be competition over design and cost. The more  
20 innovative and efficient the greater the attractive force to airports because airport charges  
21 might be lower. They say that competition will focus upon price because capital  
22 expenditure directly impacts upon charges which airports levy to the airlines, and these  
23 charges in turn are costs to the airline which must be wholly or partially passed on to  
24 passengers. So more efficient operation of new capacity may result in lower passenger  
25 fares to the travelling public.

26 They say that competition over capacity will lead to innovation, coupled to efficiency,  
27 leading to increased capacity at the lowest cost, thereby creating a potential to drive all  
28 aspects of competition, in particular price and service quality.

29 They refer to a greater range and diversity of services which would arise out of this  
30 competition. They say in particular that the new capacity would transform the way in which  
31 airports and airlines conducted business.

32 An important part of their analysis was the interaction over the terms of supply as against  
33 demand. I would like to just take you to a useful description of how competition would  
34 emerge over 30 years in Appendix 10.1, para.34. I think this is quite a useful and apt

1 paragraph and illustrative figure, figure 1, which encapsulates in really pithy and useful  
2 form why it is that competition will be so profoundly different under the 2009 hypothesis.  
3 What they say is as follows. Just so that you have it in mind, this is in a chapter or an  
4 appendix which is entitled “The need for the divestiture of two BAA London airports”.  
5 That is the heading to Appendix 10.1. It is quite an important section. What they say in  
6 para.34 is as follows:

7 “Over time, as demand grows, we would expect spare capacity to diminish until  
8 the Government provides for a new round of capacity expansion (with airport  
9 operators lobbying for it to do so). As capacity at rival airports tightens, this  
10 confers on an airport greater negotiating power. However, an airport will tend  
11 to have strong incentives to price low in the immediate aftermath of a new  
12 capacity development (giving the airlines negotiating power). As competition  
13 develops, negotiating power may ebb and flow between airport and airlines, as  
14 capacity at rival airports tightens followed by new capacity coming on stream.  
15 The south-east airports might move towards the model we observe at regional  
16 airports whereby airports and airlines enter into long term contracts. In this  
17 way, airlines and airports would trade off the difference in their negotiating  
18 strength and commercial positions to arrive at an overall arrangement which  
19 mitigates the negotiating power an airport can exercise. For example, they may  
20 be able to contract for a constant price over time (shown as  $p^*$  in Figure 1),  
21 rather than face the more volatile fluctuations in price that the airport would  
22 charge if prices reflected the amount of spare capacity that was available at rival  
23 airports.”

24 You will see that they are contemplating in figure 1 potentially three rounds of new capacity  
25 over 30 years, and this very long-term injection of new capacity completely alters the way  
26 in which people do business. For example, instead of there being fluctuating market power  
27 between supply and demand, what they are simply saying is that airports and airlines will  
28 enter long term contracts which flattens out variations in market power.

29 So very long term capacity being introduced into the market, a revolution in the way in  
30 which airlines and airports do business, and quite a different relationship in terms of market  
31 power varying over time.

32 THE CHAIRMAN: It is a small point, I am not sure they define “t” as 30 years. I thought that  
33 they were making a general point, which may well be sufficient for the point that you want  
34 to make, that there is a relationship, perhaps unsurprisingly, between supply and demand



1 here, and as the supply becomes constrained, that affects the negotiating power, and then  
2 suddenly, if you get an expansion of it ----

3 MR. GREEN: Thirty years is their timeframe. I have assumed that the timeframe they have  
4 introduced here is the timeframe they have used in their analysis. It may or may not be, but  
5 I do not think it really matters. They talk about a 30 year plus timeframe as their relevant  
6 period for assessment of the benefits.

7 The other point they make in their report is that as competition evolves, so the need for  
8 regulation would diminish, in particular at Gatwick and Stansted, and we have seen that in a  
9 paragraph already quoted. In other words, price and other controls would be removed.  
10 Then there is an important passage. If you go to para.5.20, again it is really a general  
11 observation about the way to operate the new capacity.

12 THE CHAIRMAN: This is 5.20 in the main report?

13 MR. GREEN: In the main report, the 2009 report, yes.

14 “We now set out how we expect competition to develop between the three  
15 airports. We recognize that we are unlikely to have identified all of the  
16 commercial levers that airports could flex to compete with one another and may  
17 therefore have underestimated the benefits that will flow from competition.  
18 This is because rivalry is an inherently uncertain process and, to date, there has  
19 been no competition between any of BAA’s London airports – unlike in a  
20 merger case, we cannot draw on historical observations of competition  
21 (although we can look, and have looked in detail, at how airports in different  
22 regions compete ...). It is against this complete absence of competition to date  
23 that the cumulative benefits from competition, once the airports are separately  
24 owned, should be evaluated.”

25 Every paragraph from hereon in concerns different ways in which new capacity would lead  
26 to competition, and they are the ways I have just summarised for you and which are set out  
27 in the speaking note. Can you just look at 5.26.

28 THE CHAIRMAN: Yes, just on that, in the first sentence of 5.20 they are turning to a new topic:  
29 “We now set out how we expect competition to develop” so this is their best estimate as to  
30 what will actually happen and you are right to emphasise that is against a background where  
31 it is expected that new capacity will be forthcoming.

32 MR. GREEN: Indeed actually pretty much everything from 5.14 onwards is capacity dependent.

1 THE CHAIRMAN: I am not sure that is right, is it? 5.14 last sentence they say: “Nevertheless,  
2 we set out how we expect competition to develop in future under separate ownership, given  
3 existing capacity...”

4 MR. GREEN: You will need to be careful about what they are referring to here, because they go  
5 on to explain, particularly at 5.31, 5.32 and 5.33 that they are referring to pre-emptive  
6 competition. Actually, if you go through paragraph by paragraph, as I have done, to see  
7 whether or not they are referring to new capacity (it is possible I have made a mistake and  
8 missed out the odd line) frankly, I think every single paragraph refers to capacity.

9 MR. ALLAN: Does not the parenthetical at the end of 5.12 make it clear that from 5.15 onwards  
10 they are talking about an assumption of new capacity?

11 MR. GREEN: Yes, it does. Their essential premise is that capacity will come on stream. Their  
12 essential premise is that they are utterly confident in the government’s policy continuing,  
13 that government policy being favouring new capacity.

14 THE CHAIRMAN: Yes.

15 MR. GREEN: Then

16 “5.26 Competition between these London airports would mean that instead of  
17 relying on one organisation’s (BAA’s) assessment of the impact of runway  
18 development, the Government, in determining which capacity expansions to  
19 support, would now be able to compare independent projects in terms of costs,  
20 efficiency, deliverability and impact on the environment. As a result, we would  
21 expect the Government’s decision-making process to be improved since it could  
22 no longer be influenced by the incentives that a common owner has to minimize  
23 cannibalization and managerial effort and to ensure that its most profitable  
24 projects are approved and other options discarded.”

25 The reason I am referring you to that is because it raises an issue which is going to be  
26 relevant later which is what is called “comparative competition” which is when the decision  
27 maker, the regulator, is able to improve the quality of its regulation by having different  
28 pools of information to compare and contrast. You will see that here this is a capacity  
29 dependent observation that if you have got more information from three different airports  
30 (Gatwick, Stansted and Heathrow) you can compare and contrast costs, efficiency,  
31 deliverability of improvement and impact on the environment. I will come back to  
32 comparative competition later on.

33 Just to nail the submission that in fact everything here is concerned with capacity, the two  
34 paragraphs which are not and which are really looking at how the market would develop

1 absent capacity are 5.11 and 5.12. I have to confess 5.13 could swing both ways, but it  
2 really does not matter. 5.14 is about what might have happened in the past. Again, that  
3 does not really matter for present purposes. Then at 5.14: “We set out how we expect  
4 competition to develop in future under separate ownership given existing capacity  
5 constraints.” So it is from now on in, given that we have got capacity constraints, how will  
6 it develop in the period up to runways and beyond.

7 MR. ALLAN: I am sorry, you glossed over 5.14 but it does include the statement that “we are  
8 confident that a significant degree of competition would have emerged in all possible  
9 counterfactuals” so that presumably relates to a world in which they are competing under  
10 existing constraints.

11 MR. GREEN: That is absolutely right. What one finds throughout the whole of this report,  
12 hundreds of pages, are odd statements like that. It all does boil down to Appendix 5.1 at the  
13 end of the day because that is where they actually say: right, let us get to grips with how  
14 competition would emerge absent new capacity. Everything else is really just a reflection,  
15 pale or otherwise, of that.

16 What I am proposing to do is to just take you through each paragraph and to summarise  
17 with a side heading whether it relates to capacity or not and what it relates to. 5.16, which  
18 is about Gatwick not Stansted. They say it would result in significant competitive  
19 interactions between it and Heathrow and Stansted. They say it is supposed to substitute for  
20 the two of them, it has strong rail links into London. Then they deal with the fact that under  
21 current government policy a second runway at Gatwick is explicitly supported if a third  
22 runway at Heathrow cannot be built. So Gatwick may get new capacity, contingent upon  
23 what happens at Heathrow. Ditto (d) in relation to Stansted. Then (e) is about Stansted and  
24 Heathrow developing the runway each. Then (f) "Even with new runway capacity at  
25 Heathrow and Stansted but not Gatwick, Gatwick would remain a significant London  
26 airport." So they are saying that even on the assumption that there is capacity, Gatwick is  
27 still important and they set out its position. Then they say in 5.17 it is discussed in more  
28 detail at Appendix 10.1. “We similarly expect that ownership of Stansted would result in  
29 significant competitive interactions between it and both Heathrow and Gatwick”. As you  
30 will see, again that is dependent upon new capacity. I will make good that later. Then they  
31 say Gatwick is the closest substitute to Stansted.

32 “(b) The strong substitutability between Gatwick and Stansted stems from the  
33 combination of catchment overlap and LCCs (low cost carriers) at both airports.

34 (c) In recent years, much of the competitive pressure on short-haul services at

1 Heathrow has come from the growth of LCCs at Stansted. (d) Only Stansted and  
2 Heathrow have had government support for for new runways. [This] gives the  
3 opportunity for them to compete on the design, cost and timing of major  
4 increments of capacity. [So that is capital investment. Then they talk about the  
5 opportunity.] (e) Following the building of a second runway at Stansted, Stansted  
6 would have a substantial share of London airport runway capacity (about 30 per  
7 cent) even after a third runway is constructed at Heathrow. We would expect  
8 Stansted to seek to attract airline business from the other airports, and for them to  
9 respond. The process of rivalry to win and retain airlines will induce the airports  
10 to improve their offerings to the benefit of airlines and customers. [So the process  
11 of rivalry will reduce prices, improve services etc]

12 “5.18 For similar reasons, we expect that separate ownership of Heathrow would  
13 result in significant competitive interactions between it and both Gatwick and  
14 Stansted. We discuss the development of competition further in paragraphs 5.20  
15 to 5.37. 5.19 BAA suggested that the scope for competition was uncertain,  
16 speculative and contingent on other events which are unlikely to occur. We accept  
17 that the precise outcome of competition is uncertain - that is why competition law,  
18 including the Enterprise Act, specifies a finding relating to the effect on  
19 competition itself, rather than to precise outcomes of competition. However,  
20 while the precise outcome under separate ownership is uncertain, the evidence  
21 enables us to reach a clear expectation that competition will develop.  
22 Consequently, we do not agree that the scope for competition is speculative and  
23 contingent on other unlikely events.”

24 BAA did not challenge that last time round. It may not have liked it, but it recognised that  
25 there was sufficient logic and power behind the Commission’s argument for it to be a lawful  
26 decision. Then 5.20 onwards: “We now set out how we expect competition to develop”, so  
27 they are talking about the future between the three airports, but then they say they have not  
28 identified every benefit; they may have underestimated the benefits flowing from  
29 competition. At 5.21 they say that competition is a dynamic process, quite plainly, in the  
30 context of new capacity there . At 5.22:

31 “We consider that there is considerable scope in the South-East for the process of  
32 competition to improve capacity delivery” so that is capacity related. At 5.23  
33 "BAA disagreed. It but argued that current policy as expressed in the White Paper  
34 precluded the possibility of competition over capacity delivery, as it [government

1 policy] dictated where and when airport operators should bring forward new  
2 investments. Whilst we accept that the Government has a significant role to play  
3 in determining the location of future capacity, the design, cost and timing of the  
4 capacity is not determined by the Government. We therefore see scope for  
5 airports to compete which we believe will drive improvements in the scale and  
6 design of facilities, the speed with which capacity is rolled out, the terms that  
7 airlines obtain when using airport facilities and the decision-making process  
8 relating to the location of capacity.”

9 Then 5.24 is an elaboration of the same reasoning. It plainly concerns capacity. 5.25  
10 concerns capacity and lobbying, the incentive on the parties to lobby for more capacity than  
11 BAA has in the past and “to lobby the Government accordingly for necessary policy  
12 framework”. So again it is capacity dependent. 5.26:

13 “Competition between these London airports would mean that instead of relying  
14 on one organisation’s assessment of the impact [this is the comparative  
15 competition point that I have referred you to already].

16 5.27 We accept that government policy in relation to the next round of runway  
17 capacity expansion has already been developed and therefore it may be too late for  
18 competition to bring any benefits to the decision-making process as regards the  
19 location of the next tranche of runway capacity. However, government policy  
20 provides that in the event that either of the developments at Heathrow or Stansted  
21 does not proceed, expansion at Gatwick would be supported. [Again, capacity  
22 related. 28 concerns the speed of capacity, delivery and first mover advantages.]

23 5.28 Moreover, having secured planning permission, we would not expect  
24 separate owners of Heathrow, Gatwick and Stansted to have the latitude, brought  
25 about by a lack of competitive pressure, to sequence the roll-out of capacity as  
26 BAA has done in the past. Instead, we would expect them to compete to deliver  
27 the required capacity over a time frame that reflected customer requirements.  
28 There is likely to be a significant advantage to being first to market with new  
29 London airport capacity [again, capacity related. Then para.5.29 concerns  
30 Heathrow against Stansted and the extent to which there would be competition  
31 between the two in the event of capacity.]

32 5.29 The DfT forecast 71 million passengers at Stansted in 2030 if no third  
33 runway is built at Heathrow, but only 56 million with a third Heathrow runway,  
34 and we noted in our 2008 Stansted report that BAA’s forecasts too show a decline

1 in Stansted's growth rate in 2020 due to the opening of Heathrow's third runway.  
2 Earlier modelling by BAA of SG2 [their capital expenditure in new capacity]  
3 indicated that forecast net revenue at Stansted was significantly reduced by  
4 capacity expansion at Heathrow; although assumptions in current modelling are  
5 likely to be different in a number of respects, we would not expect the conclusion  
6 that capacity expansion at Heathrow reduces forecast net revenue at Stansted to be  
7 different. This supports our view that common ownership of Heathrow and  
8 Stansted would incentivize BAA to be less aggressive in rolling out new capacity  
9 at Heathrow than separate owners of Heathrow and Stansted would be. [Then  
10 para.5.30 concerns development of capacity infrastructure]  
11 5.30 We also expect competition between BAA's London airports to result in  
12 constant pressure on airports to innovate in the way in which infrastructure is  
13 developed to meet the needs of their customers [they are talking about capital  
14 expenditure here]. This is in contrast to the status quo in which, not only is there  
15 no competition between BAA's London airports, they are also regulated  
16 imperfectly. Competition will reveal opportunities to win business through  
17 superior and innovative design, lower costs, higher quality, greater flexibility and  
18 more efficient delivery of capacity. Competition could be particularly beneficial  
19 in the context of the SG2 development [SG2 is Stansted's plans for new capacity  
20 capital expenditure] where BAA has been repeatedly accused by the Stansted-  
21 based airlines of 'gold plating' and applying a one-size-fits-all approach. [Then  
22 they refer to Section 7, the savings that could be made through greater capital  
23 efficiency over SG2.]"

24 Then 5.31 - the following three paragraphs are important because they now turn to pre-  
25 emptive competition. They start by rejecting the submission of BAA:

26 "BAA does not accept this view. BAA has argued that our analysis overlooks the  
27 impact, even in the longer term, of the current capacity situation in the South-East.  
28 This, it argued, was particularly so as regards Gatwick where government policy  
29 would severely constrain the airport's ability to deliver new capacity at least until  
30 2019 (and potentially for a significant period thereafter). Against this background,  
31 BAA argued that even with new runway capacity at Heathrow and Stansted,  
32 capacity constraints were likely to persist at Heathrow and Gatwick. Whilst BAA  
33 accepted that there could be substantial spare capacity at Stansted, it argued that it  
34 would not be sufficient to create scope for material competition if Heathrow and

1 Gatwick remained capacity constrained and subject to price caps ... To support its  
2 view, BAA said that its own forecasts suggested that, in 2020, the degree of  
3 excess demand at Heathrow would equate to 10.2 million passengers and the  
4 degree of spare capacity at Stansted and Gatwick would equate to 1.3 million and  
5 1.8 million passengers respectively.

6 5.32 The future level of demand, and hence the ratio of London airport traffic to  
7 runway capacity supported by the Government, is uncertain - particularly so in the  
8 light of unknown longer-term effects of the current global financial crisis and  
9 economic recession, and unknown future measures to address aviation's effect on  
10 climate change. We note, however, that the latest DfT forecasts show some fall in  
11 runway utilization across the London airports following the construction of new  
12 runways and associated infrastructure at Stansted and Heathrow, which have been  
13 supported by the Government. These forecasts, however, do not reflect  
14 competitive interaction between the airports nor the productivity improvements  
15 that would be expected to result from competition. In other words, it is possible  
16 that spare capacity would be greater and distributed differently from that set out in  
17 the forecasts.”

18 Then the next two paragraphs are very important.

19 “5.33 In any case, the key point is that in advancing this argument, BAA seems to  
20 have a different view of what drives competition and therefore the degree to which  
21 there is scope for competition between its airports. Specifically, BAA's view  
22 posits that airports cannot compete unless they are in possession of a significant  
23 degree of spare capacity. In contrast, we believe that so long as [which  
24 demonstrates that their analysis is conditional] there is the prospect of capacity  
25 expansions, which current government policy provides for, there is scope for  
26 competition to deliver improvements. As well as the design, cost and timing of  
27 capacity, users may benefit from pre-emptive competition to fill the prospective  
28 new capacity.”

29 Then this:

30 “Whilst the outcomes of this ...”

31 in other words, this pre-emptive –

32 “... this competition may not manifest themselves until the new capacity is  
33 actually rolled out, the decisions regarding capacity will begin to be affected by  
34 competitive rivalry following divestiture in the short term. “

1 Then, if you look at footnote 14, please:

2 “Indeed, there is even scope within the existing RAB-based system of economic  
3 regulation for the airports to flex their capital expenditure programme should  
4 this be in the interests of users.”

5 So the reference to capex efficiency is in the context of pre-emptive competition  
6 anticipating capacity.

7 THE CHAIRMAN: What does “RAB-based” mean?

8 MR. GREEN: “Regulatory Asset Base” - it is the assets which the Regulator will permit and on  
9 which they will calculate a return on capital . The only point I would draw from this, and I  
10 am going to come back to capex in due course, is that here they are referring to capex  
11 competition as an aspect of pre-emptive competition. At this stage, that is the only point I  
12 am making.

13 THE CHAIRMAN: Yes.

14 MR. GREEN: Then:

15 “Whilst the outcomes of this competition may not manifest themselves until the  
16 new capacity is actually rolled out, the decisions regarding capacity will begin  
17 to be affected by competitive rivalry following divestiture in the short term. In  
18 practice, users might experience pricing and quality benefits well in advance of  
19 capacity roll-out if an expanding airport enters into long-term contracts to  
20 reduce volume uncertainty post-expansion (airlines might obtain lower prices in  
21 the short term in exchange for long-term volume commitments) or if a non-  
22 expanding airport seeks to pre-empt the loss of incumbent airlines. Our case  
23 studies found that, in competitive environments, airports and airlines have  
24 indeed entered into contractual arrangements in order to lock in terms and  
25 therefore mitigate uncertainty on both sides. For example, Liverpool entered  
26 into a long-term contract with easyJet over the terms of the development and  
27 use of new terminal facilities.”

28 That is reflected in that table, that figure that I showed you earlier, at para.34 of Appendix  
29 10.1.

30 Then the remainder of this also concerns capacity. 5.35, the lobbying over capacity, 5.36  
31 capacities ebb and flow. This paragraph is exactly the same paragraph as para.34 of 10.1.  
32 They have just, as ever, repeated it.

33 Paragraph 5.37 is how regulation would be modified as competition develops in the light of  
34 new capacity.



1 Then finally:

2 “Heathrow is different. As discussed above, Heathrow has market power over  
3 and above what it acquires from BAA’s common ownership. This means that it  
4 is likely that its prices will need to be capped for longer than either of Gatwick  
5 or Stansted which in turn implies that, so long as it is subject to excess demand,  
6 the degree to which competitive activity such as price decreases or capacity  
7 expansions at rival airports affects Heathrow is smaller. However, this does not  
8 preclude Heathrow from operating as a constraint on Stansted and Gatwick.”

9 Again, not stated to be, and it would be mad to read it in the context of no new capacity.  
10 They are talking about how it will operate in the future with capacity.

11 “This means that, even if Heathrow is price controlled, its incentives – for  
12 example to invest in expanding capacity and improving quality – will be  
13 distorted by common ownership with Gatwick and/or Stansted.”

14 THE CHAIRMAN: So one point arising out of that, 5.17(c) does seem to refer to actual evidence  
15 of a competitive effect reflecting back from Stansted on to Heathrow. Is that right? I know  
16 you say it is much greater the other way round, but ----

17 MR. GREEN: No, I accept that, and there is a small way in which, in Appendix 5.1, the  
18 Commission identifies scope for competition between the two. As I say, I think you are  
19 right, and that is something which is called “charge rebalancing” in Appendix 5.1.

20 THE CHAIRMAN: Yes.

21 MR. GREEN: Then the summary on p.127. The only one which is relevant to the present case,  
22 because (a) concerns Edinburgh and Glasgow, (c) concerns Southampton, (d) concerns  
23 Aberdeen, is (b), and then there is a brief reference at (e) to Heathrow. Their summary as to  
24 scope for competition:

25 “(b) Common ownership is a feature of the market preventing competition  
26 between the three London airports, the extent of that competition may be  
27 limited by current capacity constraints ... but these constraints are themselves at  
28 least in part the result of common ownership. We have set out how we expect  
29 competition between the airports to develop under separate ownership. We  
30 expect competition to manifest itself straight away (particularly in relation to  
31 planning and capacity development and innovation, but we also expect to see  
32 some competition within existing constraints, though the intensity of price  
33 competition would be modest) and we consider that the benefits will increase

1 over time as the prospect of additional capacity is realised and price control, at  
2 Gatwick and Stansted at least, is withdrawn as competition develops.”

3 Just for completeness:

4 “(e) Heathrow’s position as the only significant hub airport in the South-East  
5 and indeed the UK is itself a feature that restricts competition between airports.”

6 Summing chapter 5 up, which is the scope for competition, the sum total of the scope for  
7 competition absent new capacity is that set out in 5.11 and 5.12, which they summarise in  
8 5.12 in parenthesis as “modest” and “some scope”.

9 There is no analysis of that scope, and the reason I make that particular point is because of  
10 what I am going to come to next, and I am going to start with the conclusion. I am going to  
11 come to chapter 3. The conclusion to chapter 3 is in para.3.168, so could you track back to  
12 that. I am going to make the point so that you understand what it is I am submitting.

13 Chapter 3 concerns substitutability between the airports. In one paragraph they say that it is  
14 possible that Heathrow might constrain Stansted. They make it clear in chapter 3 that they  
15 are only talking about potential and they are not measuring it or quantifying it. In  
16 para.3.168 they make this point explicit – in other words, their analysis in chapter 3 cannot  
17 be drawn upon specifically to tell you what the scope for competition would be absent new  
18 capacity. The inferences you draw from the analysis are that it is very little, but I will make  
19 that good in a moment. Paragraph 3.168:

20 “The analysis in this section has considered the substitutability of the BAA  
21 airports and non-BAA neighbouring airports for one another in two broad  
22 geographic regions – Scotland and the South-East. Overall we consider this  
23 evidence to suggest that the BAA airports are the closest demand substitutes for  
24 one another. However, we recognise that there may be external constraints that  
25 impact on the potential for competition even for very close demand substitutes  
26 in particular the existence of capacity constraints. As a result, we look at the  
27 issue of capacity constraints in Section 4 and then consider the potential for  
28 competition between the BAA airports in the presence of capacity constraints  
29 and price cap regulation in Section 5.”

30 So section 5 is where they measure the extent to which you can have competition for  
31 capacity constraints, and their basic analysis is pre-emptive competition, which is a form of  
32 capacity constraint competition, and all that is left is what we have got in 5.11 and 5.12, and  
33 that one paragraph which your Lordship referred to, 5.17(c).

34 THE CHAIRMAN: And Appendix 5.1.

1 MR. GREEN: And Appendix 5.1, exactly, precisely.

2 THE CHAIRMAN: And 5.14.

3 MR. GREEN: And 5.14.

4 So chapter 3. It is important for this reason, because if the conclusion here is that absent  
5 common ownership there is not much scope for competition, it tells you what the answer is  
6 in relation to condition 1 of proportionality. Will the remedy of divestiture be effective? If  
7 Stansted is separated from Heathrow, what impact will it have on Heathrow is the question.  
8 This answers that and it gives you the Commission's analysis and it tells you what evidence  
9 they rely upon.

10 THE CHAIRMAN: Sorry, do you not also have to ask what impact will Heathrow have on  
11 Stansted as a question?

12 MR. GREEN: Exactly, and vice versa, absolutely. I should have asked you to look at 10.117,  
13 which is a summary paragraph. It is in the speaking note, it is easier to pick it up there, at  
14 para.44. There is an inference which one draws from 10.117.

15 THE CHAIRMAN: Shall we read 10.117 to ourselves, or do you want to take us through it?

16 MR. GREEN: I would like to take you through it, if I may.

17 "We recognise that the divestiture of three airports constitutes a major  
18 intervention in the market and will have a significant impact on BAA's business  
19 ..."

20 THE CHAIRMAN: Just so I am understanding, the three airports are Stansted and Gatwick and  
21 either Glasgow or Edinburgh – is that right?

22 MR. GREEN: Yes.

23 "... and that the scale and timing of benefits are necessarily uncertain."

24 I will make the point as I go along. That goes to the intensity of the judicial review and the  
25 double proportionality described in *Tesco* and *Barclays*.

26 "However, the detrimental effects we have identified ..."

27 THE CHAIRMAN: Just picking up on that, in what way does it go to them. Does it mean that  
28 there is a wider margin of appreciation?

29 MR. GREEN: No, it means the opposite. It means that the four conditions which the court  
30 identified in *Tesco* and *Barclays* included the extent to which there was a detailed  
31 intervention in somebody's business. Here, the point you made at the outset, we are talking  
32 about the 2009 analysis, not 2011, plainly is correct, but a major intervention in the market,  
33 significant impact on BAA's business, in *Tesco* and in *Barclays* they treated these sorts of

1 factors as justifying the more detailed review – in other words, requiring the CC to conduct  
2 a more intensive analysis. That is the double proportionality point.

3 THE CHAIRMAN: But if it is inherent in a situation that it is hard to tell with accuracy in a  
4 quantitative analysis what the effects will be, then you have got an expert body drawing on  
5 its experience to say, “We think there will be a significant effect on a qualitative basis”.  
6 Why would the necessarily uncertain point not lead to a wider margin of appreciation rather  
7 than a smaller one, which is what you are saying?

8 MR. GREEN: Whether it is a wider margin depends upon the nature of the policy issue at stake.  
9 If we were dealing with broad government policy about war or immigration or something,  
10 that is one end of the scale. The other end of the scale, the Tribunal has adopted the  
11 opportunity approach. It has said there is a statutory framework with four conditions, and  
12 each of those conditions has sub-parts to it and we are going to hold the Commission to a  
13 proper analysis of each of those sub-parts. For example, if you look at *Tesco*, if you look at  
14 *Barclays*, the way in which they found that there were errors in that case, they are reflective  
15 of the sorts of errors we are identifying here. They are exactly the same sort of thing. In  
16 fact, we submit we are considerably to the right side of the *Barclays* and *Tesco* margin.  
17 The double proportionality point was – and I am just tracking back in my speaking note to  
18 paragraph ----

19 THE CHAIRMAN: I think the double proportionality point was the greater the intrusive nature of  
20 the remedy imposed, the more careful the Competition Commission should be.

21 MR. GREEN: Yes, the more you expect from the Competition Commission ----

22 THE CHAIRMAN: I was asking a slightly different question. In circumstances where in the  
23 nature of the case that is being analysed, one could not expect there to be scope for a  
24 quantitative analysis, and particularly when one is looking at 2009 the Commission makes  
25 very clear that you cannot do that because you have not been operating in a world where  
26 there has been effective market competition because all three airports in the south-east are  
27 owned by BAA. Therefore, that seems to put greater emphasis upon expert judgments  
28 about what could be expected to happen if there were competition and one might think that  
29 that meant that so far as this Tribunal is concerned it should be more of a hands-off  
30 approach.

31 MR. GREEN: With respect no. The reason why no is because you have got two types of  
32 analysis. It is often the case you cannot conduct a quantitative analysis. A qualitative  
33 analysis is precisely the sort of thing the Commission regularly engages in. I am going to  
34 show you very shortly the categories of evidence that they did engage in which they have

1 not re-engaged in, all sorts of things they could have done to assess the things that they now  
2 say they can make assumptions about. So they had the tools; there is no doubt about that.  
3 The law says if you cannot conduct a quantitative analysis you must conduct a qualitative  
4 analysis. There is a variety of techniques they can use and they are extremely well versed in  
5 them. If they do not conduct a quantitative analysis, or if there are gaps in that analysis and  
6 they have omitted to conduct something which the Tribunal finds is material or relevant,  
7 then it is really just a classic *Tameside*, they have failed to address themselves to a relevant  
8 consideration when they could have done so. So that is the approach which the Tribunal  
9 has taken in *Barclays* and in *Tesco*. Intense would be the wrong word. It is simply holding  
10 the Commission to the task required of it by the Enterprise Act.

11 MR. ALLAN: Yes, thank you.

12 THE CHAIRMAN: I stopped you reading, so shall we go on?

13 MR. GREEN: Yes. So that is the first sentence.

14 “However, the detrimental effects we have identified are long-standing problems,  
15 which go to the heart of the structure of this market and therefore require a  
16 structural remedy. Moreover, we are confident that the market characteristics  
17 which underpin the AECs and detrimental effects, would be unlikely to change,  
18 absent our remedy, due to the absolute nature of common ownership and  
19 particularly high barriers to enter. [Then one finds this] Similarly, we have little  
20 reason to believe that government policy, which has been consistently supportive  
21 of the continued growth of aviation and the provision of airport capacity to  
22 support this growth since the privatization of BAA, will change so radically in the  
23 foreseeable future as to invalidate the effectiveness of our remedy.”

24 It is a statement in the confidence that there will be new capacity. You can have degrees of  
25 change in that government policy. It may be that the government would radically change its  
26 policy by saying capacity only at Stansted and not at Heathrow or vice versa, or a limited  
27 degree of a smaller degree of capacity reflected by the smaller number of passengers that  
28 could go through an airport. That would be a change. The absolute in radical change is a  
29 complete reversal, which is what happened. There is no greater reversal than did happen.

30 THE CHAIRMAN: Did not the Commission recognise that by accepting that that was a major  
31 change in circumstance which required it to look again?

32 MR. GREEN: Absolutely. Again, it is an inference; it is not expressly stated. The last sentence:  
33 “Similarly, we have little reason to believe that government policy, which has  
34 been consistently supporting the continued growth of aviation and the provision of

1 airport capacity to support this growth since the privatization of BAA, will change  
2 so radically in the foreseeable future as to invalidate the effectiveness of our  
3 remedy”

4 Again, it is an inference; it is only implicit, but it is both an inference and it is implicit that  
5 were it to change radically it might invalidate the effectiveness of the remedy.

6 THE CHAIRMAN: Is that not why they treat it as a material change of circumstance and  
7 examine that question?

8 MR. GREEN: Exactly, and it tells you about the assumption that they made in 2009 which was  
9 that they had confidence in government policy, and it explains why they did not conduct a  
10 detailed review. You will have made your own minds up about Appendix 5.1, but it  
11 explains why they did not form a detailed view about competition absent new capacity.  
12 They were confident that the policy would be sustained. You will see from Chapter 5 that  
13 predominantly their analysis was based on new capacity. Non capacity benefits were pretty  
14 poor.

15 THE CHAIRMAN: Certainly that explains why they did not feel they had to base their decision  
16 in 2009 on the analysis by reference to existing capacity, because they did not think that  
17 was the accurate picture which the market was going to be following.

18 MR. GREEN: That is right. So coming back to Chapter 3, this is the substitutability analysis and  
19 it tells you to what extent divestiture would have any real effectiveness in generating the  
20 benefits. This is dealt with in the speaking note at paras.116 to 149. In this chapter the  
21 Commission is looking at the substitutability across the Scottish airports and all the airports  
22 in the southeast including Luton and Southampton. So only parts of it are relevant to the  
23 relationship between Stansted and Heathrow.

24 There are two inquiries which the Commission made. One was whether Stansted can  
25 constrain Heathrow and then secondly, whether Heathrow can constrain Stansted. So they  
26 looked at them as two separate issues. The reason why I used the word asymmetrical is  
27 because they found different conclusions in relation to the different direction of travel. In  
28 para.3.2 they explain why assessing substitutability is essential for assessing each airport’s  
29 market power. They used the words "assessing the extent of market power that each of  
30 BAA's airports would have if operating as a separately owned airport". So although they  
31 were not doing it for this purpose it does tell you what would happen if you divested  
32 Stansted from Heathrow. In para.3.3 they identify the effective drivers of competition.  
33 They say as follows:

1 “The market power of an individual airport depends on how far competition or  
2 other factors limit its ability to increase charges (or reduce the quality or range of  
3 services). Broadly, we can identify three main constraints on airports, of which  
4 the first two are competitive forces and the focus of our competition assessment  
5 (the third is economic regulation, imposed because competition is currently weak):  
6 (a) First, there are changes in behaviour by airlines; of which the most significant  
7 is switching of flights to rival airports, though airlines might also respond to an  
8 airport price increase by reducing flights without switching them to alternative  
9 airports.”

10 So the first driver of competition is switching. Will an airport of Stansted move to  
11 Heathrow and vice versa in response to better performance at the other airport? Will the  
12 losing airport, in order to retain custom, improve its performance commensurately?

13 “(b) Second, even when switching by airlines is not possible, changes in passenger  
14 behaviour may constrain airports due to the ‘derived’ nature of airport demand. If  
15 an increase in airport charges leads to airlines increasing fares, this is likely to  
16 cause some passengers to switch to other airports, to other methods of transport or  
17 not to travel at all. Similarly, a reduction in service quality as a result of under-  
18 investment may induce passengers to switch away to other airports or methods of  
19 transport, or not to travel at all.”

20 So the second is: if the airlines cannot switch, will the passengers exert some pressure on  
21 the airport or the airline because they feel that they want to get better performance, better  
22 prices elsewhere?

23 “(c) Third, airports may be constrained by regulation. Under current regulatory  
24 arrangements, BAA’s three London airports are designated for price control and  
25 the CAA imposes a cap on average airport charges per passenger.”

26 THE CHAIRMAN: Just on (a), presumably the substitutability of airports from the customer’s  
27 point of view will be relevant to (a) as well because airlines will only want to change if they  
28 are still going to be able to tap to a sufficient degree the market that they were tapping  
29 before.

30 MR. GREEN: Yes. If the passenger says: I really want to fly with you, X airline, but in a sense I  
31 want to fly from Heathrow, if the airline cannot switch to Heathrow that form of secondary  
32 derived passenger pressure does not take you anywhere because it cannot be responded to;  
33 the airline cannot switch. The third level is passengers exerting some direct pressure on the

1 airport itself as opposed to the airline. These are the things the Commission examined at  
2 3.4:

3 “Whilst we have identified airline behaviour as an independent constraint, it is  
4 important to recognize that the behaviour of airlines is conditioned by the  
5 behaviour of the passengers to whom the airlines must sell their own services. An  
6 airline is likely to be able to switch its flights to another airport only if passengers  
7 are willing to use that other airport.”

8 That is the point you were making.

9 THE CHAIRMAN: It is, yes.

10 MR. GREEN: You have got to be able to switch in order to respond to the passenger pressure.

11 “The extent to which passengers regard airports as substitutes is therefore relevant  
12 to assessing both the first and second constraints mentioned above.”

13 What I was going to do now was to take you to the paragraphs. I will be very happy, if Mr.  
14 Beard wants me to, to read anything else. I was going to take you to the paragraphs which  
15 affect Stansted and Heathrow. I probably ought to just read 3.5 and 3.6:

16 “3.5 However, it is unlikely that the degree to which airlines substitute between  
17 airports will be identical to passengers’ willingness to do so. This is because  
18 airlines may display a higher willingness to substitute than passengers if they can  
19 credibly threaten to switch some or all of their flights to a rival airport. There  
20 may, however, be costs or other disadvantages for an airline in moving aircraft  
21 from one airport to another, particularly if the presence of an airline at the  
22 alternative airport is low. These costs include establishing new routes or  
23 schedules, the costs of moving facilities (which are likely to be particularly  
24 significant if a maintenance base is located at the airport) and the costs of  
25 relocating staff and crew. Switching costs are discussed further in Appendix 3.1  
26 “3.6 One of BAA’s arguments in relation to Heathrow and Stansted was that  
27 airports serving different types of airlines belonged to different markets. It said  
28 that this was because airports could only compete to attract airlines and not  
29 passengers, and so it was immaterial whether or not passengers considered the two  
30 airports demand substitutes. BAA noted that there was limited overlap of airlines  
31 at Heathrow and Stansted, and attributed this to Heathrow being a hub airport  
32 serving network airlines and Stansted being a point-to-point airport serving mainly  
33 LCCs. We consider the issue of Heathrow as a hub airport in paragraphs 3. 127 to  
34 3.133. More generally, we consider the point made in paragraph 3.3(b) to be



1 relevant here, namely that passenger switching can constrain airport behaviour  
2 even when airline switching is not possible because of the ‘derived’ nature of  
3 airport demand. We also consider that some airports, such as Heathrow, can have  
4 a position of substantial market power because of, for example, a favourable  
5 location, but can nonetheless provide an effective constraint on other airports such  
6 as Stansted. Finally, we note that the lack of observed switching by airlines  
7 between Heathrow and Stansted, as well as the differences in the type of airline  
8 that use these airports, could reflect the lack of incentives for a common owner to  
9 market the airports as substitutes. We discuss this latter point further in  
10 paragraphs 3.26 and 3.28.”

11 What really matters here is what they found specifically about Heathrow and Stansted, and  
12 the evidence they relied upon and the conclusions they came to about those two airports.

13 I wonder if that might be an appropriate moment.

14 THE CHAIRMAN: Yes, very well, we will rise. 2 o’clock.

15 (Adjourned for a short time)

16 THE CHAIRMAN: Yes, Mr. Green?

17 MR. GREEN: I was continuing with my review of the report, and I am afraid I am going to have  
18 to spend a little bit more time doing that before we get down to Appendix 5.1, because it is,  
19 in our submission, essential underpinning for that analysis.

20 THE CHAIRMAN: All right, but I think you can take it that the Tribunal has read the bits we  
21 were told to read of the report and has got very firmly in mind that in the 2009 report  
22 certainly the main thing that was driving the assessment of the benefits that would accrue  
23 from divestiture was the expectation that there be new capacity, and that picture has  
24 radically changed by the time one comes to the 2011 report.

25 MR. GREEN: That is helpful. I will try and accelerate my review of chapters 3 and 5. If the CC  
26 want me to read anything I will, but I think it can be taken reasonably quickly.

27 THE CHAIRMAN: Chapter 3 is dealing with substitutability. In a sense, that has a life separate  
28 from whether there is additional capacity or not, in that customers who might be prepared to  
29 go to Heathrow instead of Stansted because they have got better options there in terms of  
30 general airport services, but also flights will go there. I am not quite sure of the point that  
31 you are trying to make on chapter 3.

32 MR. GREEN: This, in a sense, answers proportionality condition one. If you divest Stansted - let  
33 us assume that it is no longer owned by BAA – will it constrain Heathrow and will  
34 Heathrow constrain Stansted? Is there anything about common ownership which affects

1 their ability to compete with each other. This says that, in fact, the extent to which they can  
2 compete with each other is quite independent of and will not be affected by, at least, in our  
3 submission, to a material degree, common ownership. That is because, one, Heathrow has  
4 unique characteristics which the CC, themselves, recognise. It is a hub airport and airlines  
5 just will not switch away from it. That is the evidence which they rely upon. If there is a  
6 better performance at Stansted, say, and assuming there was capacity at Stansted, the  
7 airlines who are at Heathrow just will not switch. That means that if you divest Stansted,  
8 this tells you what is likely to happen. It is the clearest evidence that there is which  
9 indicates what the effectiveness of the remedy is going to be. Their findings, we submit,  
10 indicate that if you divest Stansted away from Heathrow, so they are now in competition  
11 with each other, these findings indicate that there will be very little impact on each other.  
12 Of course there will be some.

13 THE CHAIRMAN: Just on the “there will be some”, I was just going to go back to 5.17(c), you  
14 remember the sub-paragraph I took you to before, which seemed to show that there had at  
15 least been some competitive impact in terms of switching of routes at least from Heathrow  
16 to Stansted.

17 MR. GREEN: This is where you get that evidence. This is where the guts of whether or not the  
18 remedy is going to be effective is answered by this analysis.

19 THE CHAIRMAN: So is the headline for our understanding your submission that in chapter 3  
20 one sees some effects, but they are very slight, and they will not be sufficient to sustain the  
21 proportionality analysis later. That is the point you are making?

22 MR. GREEN: Yes.

23 THE CHAIRMAN: Thank you.

24 MR. ALLAN: Can I just add perhaps that part of the CC’s case, as I have understood it, is that  
25 there is a trilateral dimension to this, and Stansted, Gatwick and Heathrow are all operating  
26 upon each other. Is that something you are going to cover in this ----

27 MR. GREEN: It is an irrelevance, because Gatwick now is in competition with Stansted.  
28 Gatwick is in competition with Heathrow. You have got two-thirds of the equation  
29 operating already in 2011, not in 2009. If one wants to put it in these terms, one of our most  
30 elementary submissions is the Commission, in identifying whether it was proportionate to  
31 divest Stansted, should have said, “One, in view of our conclusions about substitutability,  
32 will it have any serious incremental effect? Two, given that we are going to continue with  
33 regulation, what is the impact over and above regulation, because that is a given? Three,  
34 given that Gatwick is now in separate ownership, will Stansted exert an incremental effect

1 over the combined effect of regulation and Gatwick?” When you look at all their prior  
2 findings, the answer to that is really, no, or no material impact. Those were the givens in  
3 2011. Gatwick was separate, they are going to continue with regulation for a longer period  
4 of time. In order to decide whether it was proportionate to smash BAA up and tell it to sell  
5 Stansted, you have to ask, what is that going to bring to the party, given that Gatwick is  
6 exerting whatever effect they wanted it to have, and it is a stronger effect than Stansted,  
7 given that regulation will continue, and regulation is designed to compensate for the lack of  
8 competition.

9 So it is what is the incremental effect? It is standing third in the queue. Chapter 3 tells us  
10 that absent anything else, the competitive effect between the two airports is very limited. I  
11 do not want to over-exaggerate it. I am not saying it is zero, but their own conclusion is that  
12 it is very limited.

13 THE CHAIRMAN: Right, take us through and show us that.

14 MR. ALLAN: And we will wait for Mr. Beard perhaps to explain how he sees it.

15 MR. GREEN: I will come to it because in 2009 the Commission identified the series of questions  
16 it needed to ask, and those are the three questions which I have just put to you. They  
17 accepted that that was the correct framework for analysis.

18 Chapter 3, and I will deal with it as fast as I can so we can get down to Appendix 5.1  
19 finally. The introduction to it, paras.3.1 and 3.2:

20 “3.2 Assessing airport substitutability is an important step in our competitive  
21 effects analysis because substitutability is central in:

22 (a) assessing the extent of market power that each of BAA’s airports would  
23 have if operating as a separately owned airport ...”

24 in other words, if divested.

25 “(b) assessing the additional market power held by BAA as a result of its  
26 common ownership of many airports. This depends on the degree to which  
27 competitive constraints have been removed by common ownership. The extent  
28 to which the substitutes for BAA airports are other BAA airports rather than  
29 non-BAA airports is relevant here.”

30 3.2(a) is a correct identification of why this is relevant.

31 Between here and the rest there is a lot about Scotland which I am going to jump over. I  
32 have read to you 3.3 which identifies the three drivers for competition. We then jump over  
33 Scotland to 3.89. We are now in a section entitled “The BAA south-east airports”. A good  
34 part of this analysis does not particularly trouble us. It is just deciding who is a closer

1 substitute, and it is common ground between us that Gatwick is the closest substitute, and  
2 Stansted stands behind them, to the other two airports. 3.89 is indicative of the relevance of  
3 this chapter:

4 “Much of the evidence we discuss below is based on the status quo in which the  
5 BAA airports are under common ownership, face some capacity constraints and  
6 are subject to economic regulation. We would expect the degree of substitution  
7 we find between BAA’s London airports to be higher under separate ownership  
8 than under common ownership if ...”

9 so it is conditional –

10 “... this resulted in greater differences in the prices charged at, and/or different  
11 marketing efforts at, and/or an increase in the number of routes served from,  
12 one or more of BAA’s airports rather than from all of them.”

13 In a sense, that is answering proportionality condition one. If they were separate, would  
14 they generate these sorts of benefits?

15 Then there is a lot of analysis called “Inter-airport exposure”, which we can jump over. I  
16 would like to start at 3.111 to show you what evidence the Commission relied upon in  
17 coming to its conclusion. You will see that in relation to almost but not quite ----

18 THE CHAIRMAN: I am sorry, why are we skipping “Inter-airport exposure”?

19 MR. GREEN: This is telling you about the exposure to, for example, Southampton,  
20 Bournemouth, Heathrow – it is not really relevant to telling you what would happen if  
21 divestiture of Stansted occurred. It gives you a better indication of who are the closest  
22 substitutes, but it does not tell you how close. It may tell you that Gatwick is a close  
23 substitute for Heathrow, but it does not say if it is a strong substitute or a weak substitute,  
24 you just simply know that it is “the closest”.

25 THE CHAIRMAN: What is the significance of the percentage thresholds that they give? That  
26 seemed to be an effort to quantify it in some way, but perhaps I have misunderstood.

27 MR. GREEN: The effort to quantify really comes from their analysis of the evidence  
28 demonstrating to what extent the closest substitutes constrain each other. If we start with  
29 the assumption that Gatwick is the closest substitute to Heathrow and then Stansted, one is  
30 then asking the question, “How effective are they as disciplines to each other?” That comes  
31 with the start of their analysis of the evidence at 3.111.

32 THE CHAIRMAN: I am quite ready to be told that I have misread this bit of the report, but I was  
33 rather reading the section on inter-airport exposure as an attempt to work out how  
34 substitutable each of the relevant other airports were – is that wrong?

1 MR. GREEN: It tells you about catchment areas. I am happy to take you through it if you wish,  
2 but it does not advance the analysis.

3 THE CHAIRMAN: I had got the impression that if the percentage of share threshold was low,  
4 that suggests low substitutability, in which case one would not expect significant  
5 competitive effects, but if high that suggests a significant degree of substitutability, in  
6 which case you would expect competition effects to be high.

7 MR. GREEN: The problem with the analysis here is that if you have, let us say, a fairly high  
8 figure, it tells you about the potential. For example, if the catchment area of Gatwick and  
9 Heathrow overlap substantially you would expect passengers to go either way and airline  
10 passengers to go either way, and perhaps they would compete for non-transfer passengers.  
11 However, if there were other factors which prevent that from occurring the potentiality does  
12 not turn into an actuality.

13 THE CHAIRMAN: What is the basis for the Competition Commission saying that in terms of  
14 substitutability, if you are looking at Heathrow, the next one is Gatwick, then Stansted; if  
15 you are looking at Stansted, the next one is Gatwick, then Heathrow? I had thought that it  
16 was coming out of the analysis of inter-airport exposure, but I could be wrong. I may have  
17 read it too quickly. What do you say is the basis for that hierarchical ordering?

18 MR. GREEN: It is partly this, the hierarchical ordering – there are two questions which one  
19 needs to ask: first of all, is airport A in principle substitutable with B? You would look at  
20 its catchment area. If you decide that the closest substitute to Heathrow is Gatwick, that  
21 does not necessarily tell you whether it is very close. It may be number one in the potential  
22 substitutes, but it does not tell you whether it is close or distant. The analysis of what  
23 actually happened and the qualitative evidence they have is that which actually then leads to  
24 their conclusion.

25 THE CHAIRMAN: So just in a sentence what do you say the section dealing with inter-airport  
26 exposure is assessing? What are they trying to measure there?

27 MR. GREEN: I am trying to find the easiest paragraph.

28 THE CHAIRMAN: They explain their methodology when dealing with the Scottish airports and  
29 they say they are using the same methodology as before. Perhaps you can come back to us  
30 with the best cross-reference that explains what is going on there.

31 MR. GREEN: I think you get an idea, if you look at, in relation to Scotland, 3.43.

32 THE CHAIRMAN: We will take a quick look at that. (After a pause) In crude terms, is it trying  
33 to measure the extent of overlap of catchment area for the airports?

1 MR. GREEN: Yes, and as they say in the last sentence, this is subject to other factors which  
2 might limit competition such as capacity constraints. If you like, it is the first step.

3 THE CHAIRMAN: It is quite an important step, is it not? If you were examining Heathrow as  
4 against Aberdeen, you might have a zero district share threshold?

5 MR. GREEN: Yes, indeed.

6 THE CHAIRMAN: But when you are looking at Gatwick against Heathrow they are much  
7 closer.

8 MR. GREEN: That is right.

9 THE CHAIRMAN: For the reasons that we were talking about before in relation to 3.3 and 3.4,  
10 do you remember our debate about 3.3(a) and (b) and I made the point, and you helpfully  
11 pointed out that is the very point made in 3.4. That suggests that the catchment area is  
12 actually going to be a very important factor in determining whether there is likely to be  
13 significant competition between airports or not.

14 MR. GREEN: Well it turns out not. That is the conclusion which it comes to. I think the answer  
15 is if there were no capacity constraints the answer is yes, that would give you a very clear  
16 indication that they were potentially strong competitors with each other.

17 THE CHAIRMAN: All right. So you are going to show us that notwithstanding what seem to be  
18 relatively high degrees of inter-airport exposure between Heathrow and Stansted, they  
19 concluded it does not --

20 MR. GREEN: Yes, quite. The Competition Commission set out the evidence that it relies upon  
21 from para.3.111 onwards. What I propose to do is, I am not going to read it out, but I will  
22 identify what the evidence was and whether or not it was relevant to the position between  
23 Heathrow and Stansted.

24 THE CHAIRMAN: I am so sorry, Mr. Green, I missed that latest reference you gave us.

25 MR. GREEN: 3.111. Between 3.111 and 3.123 the Commission referred to two sources of  
26 survey evidence they had, trying to work out how the airports constrained each other. One  
27 was a 2006 survey by the Civil Aviation Authority, and secondly a 2006 survey by BAA.  
28 The CAA survey is at 3.112 and 3.113. The Commission is cautious about relying upon  
29 this. For example, you see a reference at the bottom of 3.113: "In view of the difficulties in  
30 interpreting responses from the Scottish airports, we would also be cautious about making  
31 inferences from responses at price-capped airports." Nonetheless, it is quite useful  
32 information.

33 The survey which is referred to here, if you turn the percentages round (they put them one  
34 way) but 83 per cent of Stansted passengers would not switch in response to a £5 fare

1 increase or not travel, and 90 per cent of Heathrow passengers would not switch or decline  
2 to travel.

3 THE CHAIRMAN: I am sorry, which paragraph are you taking this from?

4 MR. GREEN: I am taking it from 3.112 and 3.113. So they are trying to get an idea here of price  
5 sensitivity. If prices go up will people switch? There is an important fact finding of the  
6 Commission. You may want to just put a note by the side of this. 3.134(c). It is rather an  
7 important point and perhaps worth having this in mind at the outset that there is a high  
8 degree of price insensitivity between passengers. In other words, price increases, fare  
9 increases, do not lead passengers to switch.

10 THE CHAIRMAN: Sorry, where do you get a high degree of price insensitivity?

11 MR. GREEN: 3.134(c) which probably should be noted beside this point. This is part of their  
12 conclusions. Let me just read them.

13 “The results of surveys carried for the CAA and BAA also suggest that passengers  
14 regard BAA’s three London airports as better alternatives for each other than non-  
15 BAA airports. As with our own survey for Scotland, the CAA’s survey also  
16 indicated relatively low passenger sensitivity to fare increases (83 to 91 per cent of  
17 passengers not switching in response to a £5 increase in air fares, equivalent to an  
18 increase of approximately 50 to 100 per cent in airport charges).”

19 So if airport charges go up massively and this trickles down into passenger fares, this is not  
20 going to induce substantial switching. The reason why it is important that the Competition  
21 Commission links this to airport charges is because there are a number of things which can  
22 affect passenger fares and landing charges which are nothing to do with an airport. But  
23 charges which are levied by the airport which are passed on to the fares manifestly can  
24 impact on passengers. What the Commission is saying is that something which BAA can  
25 control, charges, even if it goes up massively - 50 to 100 per cent (which could never  
26 happen because of the price regulation but assume it did) - they are not going to see  
27 passengers switching. That is a very important conclusion which demonstrates that even  
28 absent common ownership price differences at one airport or another due to increases in  
29 charges are not going to lead a significant number of passengers to switch. They describe it  
30 as low passenger sensitivity. That is one important fact which comes out of this, the classic  
31 sort of analysis which regulators do and upon which regulators place a very great deal of  
32 store.

33 The Commission also refers to the BAA survey conducted at Heathrow, Gatwick and  
34 Stansted in the summer of 2006. It is interesting to look at the questions which were asked

1 which are at footnote 36 and 37. The question asked was: “Other than [the name of the  
2 airport] for the trip you are about to take, which airport did you consider flying from?” So  
3 they are simply asking who did you consider flying from. Then the next question, 37: “If  
4 the same service was available at all airports for the same price, which would have been  
5 your first choice airport, and which would have been your second?” So there are some  
6 fairly heavy assumptions built into the questions. Assuming it was available, which of  
7 course it might not be; and assuming it was exactly the same price. But even in relation to  
8 this relatively low level of question the answers show a very limited degree of even  
9 checking between Heathrow and Stansted, and the figures are effectively 11 per cent of  
10 Heathrow passengers put Stansted as third choice. This is the statistics in 3.114(a), (b) and  
11 (c).

12 THE CHAIRMAN: Right, OK. Am I understanding this right: if everything is the same where  
13 might you go?

14 MR. GREEN: Yes, if it is available and the same price who would you consider going to? The  
15 question did not say who would you go to. It is a fairly loose question but be that as it may.

16 THE CHAIRMAN: All right, but if people are saying even if it is at the level of 11 per cent, even  
17 if everything is the same: price and everything else, I still would have considered going to --

18 MR. GREEN: A relatively low percentage of people would go to one other than Heathrow.

19 THE CHAIRMAN: And one might expect those figures to rise when you change the predicate  
20 and say: it is not the same service, it is a significantly better service somewhere else.

21 MR. GREEN: Assuming you can get a competing airline. That is where the price sensitivity  
22 analysis is important. That is why their conclusion, which is their main conclusion, is that  
23 there is no price sensitivity, that is the evidence which they treat as their conclusion.

24 THE CHAIRMAN: Except in 3.113 they say they are cautious about making inferences.

25 MR. GREEN: Yes. They can only take the evidence that they have got. At the end of the day the  
26 evidence is not compelling that there are going to be strong competitive forces either way.

27 THE CHAIRMAN: Yes.

28 MR. GREEN: There is the airline evidence that they refer to at 3.117 onwards.

29 THE CHAIRMAN: If we are moving on to airline evidence what is the relationship between the  
30 passenger survey evidence and the inter-airport exposure evidence?

31 MR. GREEN: The inter-airport exposure evidence is on a different data set; it is not based upon  
32 the hypothesised or the tested reaction of the consumer. Can I come back to that and give  
33 you a proper explanation of how that works?



1 THE CHAIRMAN: Yes, that would be helpful. They seem, in the report, to have a subheading  
2 “inter-airport exposure”.

3 MR. GREEN: Essentially, as I understand it, it is a catchment area so that it is a geographical  
4 analysis of the extent to where the passengers come from rather than testing the passengers’  
5 reactions. It is a static analysis.

6 MR. BEARD: If it assists I think it is subparagraphs (a) and (b) in 3.134, so when Mr. Green was  
7 going through the conclusions he started at (c), but if you look at (a) and (b) I think that  
8 might be the out turn of the inter-airport exposure analysis which is the catchment area. It is  
9 not specifically correlated by reference to the sections, but I think when you read it like that,  
10 and of course it is also in the relevant order, the preceding chapter runs through. I am sorry,  
11 I did not mean to interrupt.

12 THE CHAIRMAN: Yes, 3.134(a), you may well be right, but it is the relevant conclusion from  
13 the section on inter-airport exposure. It does not actually describe the methodology.

14 MR. GREEN: Let me come back to you on that.

15 THE CHAIRMAN: By all means, yes.

16 MR. GREEN: It is much more sensible and it will take less time.

17 THE CHAIRMAN: Yes.

18 MR. GREEN: The airline evidence assumes the questions were put by the CAA to the airlines at  
19 3.117. But they asked airlines which other airport, BAA and non-BAA, were a substitute  
20 for each of the BAA south-east airports from which they operated, assuming slots could be  
21 obtained. So the assumption was that there was capacity and that is a very big assumption  
22 but nevertheless it is the assumption that was made.

23 “A majority of respondents operated from Heathrow and a number of these  
24 airlines noted that other airports were not good substitutes for Heathrow as they  
25 did not have the connecting flights. Five airlines mentioned the presence of  
26 alliance partners at Heathrow with whom they would not have the same degree of  
27 connectivity at other south-east airports. Three of these airlines said that other  
28 BAA airports did not currently represent a viable substitute for their operations at  
29 Heathrow. A fourth airline said that Heathrow connecting passengers would find  
30 Gatwick to be a moderately effective substitute but not Stansted, and pointed out  
31 that the costs associated with transferring services from Heathrow to Gatwick or  
32 Stansted would be extremely high. The remaining airline in this group told us that  
33 there were no other London airports, including Gatwick, Stansted, Luton and  
34 London City, that were substitutable for its hub operations at Heathrow. A

1 different airline commented that its ability to move point-to-point services from  
2 Heathrow to another airport such as Gatwick was limited as services out of  
3 Heathrow generated gains through network effects (ie by increasing the number of  
4 transfer passengers) which were largely lost if the services were moved.  
5 However, this airline said that low-margin point-to-point routes may be switched  
6 from Heathrow to Gatwick if they could be operated more profitably there. As  
7 regards terminating passengers, airlines had a range of views but a number made  
8 the point that Heathrow was preferred to Gatwick by many passengers, in  
9 particular business passengers, with the result that Heathrow flights obtained  
10 higher yields. One airline said that by using London City as a substitute for  
11 Heathrow, it would generally see no change in yield (although it thought costs  
12 would most likely increase).”

13 So none of the airlines said that Stansted was a substitute on any basis. Gatwick possibly  
14 but not Stansted. And switching costs would be very high, even to Gatwick. So not a  
15 single one referred to substituting anything in Stansted. Then at 3.118:

16 “As to Gatwick, one airline observed that, in general, network effects would  
17 increase on services moving to Heathrow (although it noted that capacity  
18 constraints meant that such moves could only be accommodated by another  
19 service being moved out of Heathrow to make space). Another airline observed  
20 that its Gatwick route network (which was operated by non-based aircraft) might  
21 be moved but the most realistic substitutes were all BAA-owned airports. Some  
22 airlines said that higher yields could be obtained at Gatwick than at Luton and  
23 Stansted. One charter airline said that it believed there was no realistic substitute  
24 for Gatwick as charter airlines could not operate out of Heathrow, but that  
25 Stansted and Luton could be substitutes although charter passengers tended to  
26 prefer Luton.”

27 So as far as there is competition it now exists. Nothing about divesting Stansted from  
28 Heathrow is going to affect that particular dynamic. Then Stansted:

29 “In respect of Stansted, one airline said that should slots become available at the  
30 other London airports, it would be possible to move some aircraft out of  
31 Stansted, although there still remained a significant local catchment area for  
32 each of the London airports, according to CAA data.”

33 So the airline does not suggest substitutability with Stansted, and indeed airlines would only  
34 move out of Stansted if there is capacity, if slots became available.

1 Then 3.120 concerns Southampton which we need not trouble you with.

2 Then 3.121, this evidence obviously concerned the CC. It was worried about it because it  
3 did not give it the answer it wanted. So it said:

4 “Whilst we asked airlines about substitutability assuming that slots could be  
5 obtained, it may, and probably will, be the case that some airlines took into  
6 account the existing capacity situation of BAA’s London airports, which  
7 influenced their answers. If this was the case, it may mean that airlines have  
8 underestimated the degree of substitutability between BAA’s London airports if  
9 there was more capacity at these airports.”

10 It does not affect the present analysis because there is no additional capacity, even if they  
11 did misunderstand the position.

12 3.122 concerns evidence of airlines operating at BAA airports as to their perceptions of who  
13 their three closest competitors were. This is not an analysis of how close the competitor  
14 might be, it is simply who is your closest competitor, even if it might be relatively distant?

15 In this paragraph it simply tells you that Gatwick is the closest rival to Heathrow and  
16 Stansted comes second.

17 The next paragraph is the paragraph which actually does refer to some competition  
18 involving Stansted. It is evidence of new entry, and in para.3.123, the Commission cites  
19 three pieces of evidence from the past, which suggest that when an airport can start a  
20 service at a London airport, this might create a competitive ripple at another airport. It is  
21 clear that it is a historical analysis referring to past entry based upon capacity being  
22 available, and it has limited indicative value for that reason. Nonetheless, it does concern  
23 Stansted, so it is important. 3.123 says:

24 “The above analysis confirms other evidence we have seen of the impact of  
25 competition between services from the different London airports listed below:  
26 (a) BA gave us a number of examples of competition at Stansted affecting its  
27 services from Heathrow. In one case, entry at Stansted by an LCC increased the  
28 overall size of a particular route, but also increased price competition at  
29 Heathrow, with a reduction in yield of about one-third in economy class. BA  
30 moved its services to Gatwick, and then discontinued the route. Loss of  
31 passengers as a result of growing competition from LCCs at both Luton and  
32 Stansted more generally caused BA to change the commercial proposition for  
33 short-haul services, as a result of which it competed more effectively with the  
34 LCC sector.”

1 So there are illustrations of new entry at Stansted, but of course it assumes capacity. We do  
2 not know what these examples were or what capacity they used or how they entered the  
3 market, but it is right to say that there was new entry which caused ripples.

4 Then:

5 “(b) There are other published case studies of new routes from newly-served  
6 airports attracting share from established services from existing airports; for  
7 example, as quoted in an article by Sean Barrett, by 2002 new services from  
8 Stansted, Luton, Gatwick and City had a 50 per cent share of Dublin-London  
9 passengers, previously only served from Heathrow.”

10 So that is new entry prior to 2002. Again, it does not tell you what the state of capacity was  
11 at the time, and it does not give you an indication of what that might indicate going forward.

12 Then:

13 “(c) Relative growth rates at the London airports: shortage of capacity at  
14 Heathrow and Gatwick, and the competition from LCCs at Stansted, have  
15 resulted in Stansted increasing its share of London area passengers from 5 per  
16 cent in 1997 to 17 per cent in 2007.”

17 So they are talking about a historical ten year period prior to 2007.

18 When they talk about shortage of capacity at Heathrow, they are not talking about Heathrow  
19 losing business because on this analysis it was never entitled to win it in the first place,  
20 there was not any capacity there. Ditto Gatwick. So if Stansted had capacity at that point in  
21 time, between 1997 and 2007, then plainly it was a place where you could start a new  
22 business.

23 This is about the only evidence that there is – and I will just take you quickly through the  
24 rest of it – which governs Stansted. It is the totality of it.

25 At 3.124 is an assessment of switching between BAA airports and neighbouring airports,  
26 and there are two paragraphs. Paragraph 3.124 concerns Southampton. There is no  
27 mention of Stansted here. 3.125 is Luton and Stansted, but note that one of the points made  
28 in this is that once Luton became capacity constrained its ability to compete with Stansted  
29 was reduced.

30 Then 3.126, which is important not least because it does not say anything about Stansted of  
31 any materiality:

32 “As noted above, there are a number of factors affecting the potential for  
33 competition in the London area including the importance of runway capacity  
34 constraints, the special position of Heathrow as a hub airport and the special

1 position of London generally. Nevertheless, there have been examples of  
2 switching involving BAA's London airports. BAA suggested that the majority  
3 of switching to/from BAA airports related to BA switching routes between  
4 Heathrow and Gatwick because of changes in BA's strategy and for reasons  
5 such as the desire to benefit from good connectivity at 'hub' airports; desire to  
6 utilise slot capacity better; responses to inter-airline competition; operational  
7 limitations at airports; and attempts to realise cost synergies through route  
8 consolidation at an airport. However, BAA did also say that 'there have been a  
9 number of examples of where airlines have switched routes or bases between  
10 airports because they have received better deals elsewhere though in most cases  
11 these have been LCCs'. BAA's analysis showed:

12 (a) four switches of routes from Gatwick to Luton ..."

13 so not Stansted/Heathrow –

14 (b) three switches from Stansted: two to Gatwick ... and one to Luton ..."

15 None to Heathrow. There is no evidence of switching between Stansted and Heathrow.

16 In the report, if one moves from that to the special features of Heathrow. That is the  
17 evidence they have got. The totality of it so far as Stansted is concerned is that in 3.123  
18 which concerns old entry in which there is assumed to be some capacity and there were  
19 some ripple effects, that is what they say. That is it, that is the totality of the evidence. We,  
20 of course, rely upon that to show that the Commission did not have evidence to demonstrate  
21 a strong relationship between Stansted and Heathrow.

22 Then they come on to describe more qualitatively why that is the case and then come to  
23 their conclusions. Paragraphs 3.127 to 3.133 concern the special features and  
24 characteristics of Heathrow. These characteristics make Heathrow essentially immune from  
25 competition. 3.127 identifies the characteristics that differentiate them from other airports.

26 THE CHAIRMAN: When you say "essentially immune from competition", do we read that  
27 subject to your previous qualification?

28 MR. GREEN: Yes.

29 THE CHAIRMAN: We write down for advocate's licence – just so that I understand. If you are  
30 ever going to make a stronger point can you indicate it to us because ----

31 MR. GREEN: No, you are absolutely right.

32 THE CHAIRMAN: Just so that we are clear, if you are going to make a point that there is just no  
33 evidence at all of some effect -----

34 MR. GREEN: Then I shall make it absolutely.

1 THE CHAIRMAN: Yes, and make it clear that that is what you mean. Thank you.

2 MR. GREEN: Paragraph 3.127, these are the characteristics which differentiate it from other  
3 airports. It is the only south-east airport with two full length runways, its location to the  
4 west of London and its excellent transport connections to Central London are advantages ---

5 THE CHAIRMAN: I think you can take it that the Tribunal has read this, we understand the  
6 concept of Heathrow as a hub airport and that is some constraint.

7 MR. GREEN: Then 3.129 is a conclusionary paragraph.

8 “Reflecting the above characteristics, it is currently very difficult for airlines to  
9 switch existing services from Heathrow to other airports (see Appendix 3.1). It  
10 is also difficult for airlines to develop services to long-haul destinations at  
11 alternative airports to rival those from Heathrow, as other airports do not benefit  
12 to anything like the same extent from transfer passengers, and also are at a  
13 locational disadvantage in attracting business travellers. We note that airlines  
14 operating out of alternative airports compete with airlines operating from  
15 Heathrow for short-haul non-transfer passengers... and we also accept that  
16 airlines operating from alternative hubs (such as Paris Charles de Gaulle,  
17 Amsterdam and Frankfurt) compete with Heathrow airlines for transfer  
18 passengers. Nevertheless, we consider that any constraint imposed by such  
19 competition on Heathrow is weak.”

20 They do not define “weak”, but “weak” means “weak”, or it could mean “*de minimis*”.

21 There is no further analysis than that you have seen in the report. As particularly between  
22 Stansted and Heathrow, I think it would be fair to say it was “weak” (underlined) or “very  
23 weak”, but “weak” probably suffices.

24 Then 3.130:

25 “In other words, even in the absence of BAA’s common ownership, Heathrow  
26 has substantial market power as a result of the difficulty of switching services to  
27 other airports, network effects and locational advantage. We consider that  
28 Heathrow is likely to retain this market power for a considerable period, even if  
29 other London airports were under separate ownership. Similarly, the CAA told  
30 us that it accepted that Heathrow can be expected to enjoy a sustained period of  
31 substantial market power – by virtue of its location, surface access  
32 infrastructure and hub status – that is likely to warrant detailed economic  
33 regulation for the foreseeable future.”

1 So a weak competitive constraint. If you divest Stansted, competition on Heathrow from  
2 Stansted is weak, or very weak. It does not really matter how one describes it, the facts are  
3 the facts as they have been set out here.

4 At 3.131 they move on to the other way round, Heathrow as a constraint on Stansted and of  
5 course Gatwick. This is where I say there is a degree of asymmetric analysis because here  
6 they do contemplate some possibility for competition. Again, it is not a criticism we make  
7 of the CC in 2009. They did not need to establish that divesting Stansted was based upon  
8 non-capacity. The premise was quite different to that which they are examining here, which  
9 is that in the future there will be capacity. So 3.131:

10 “Although Heathrow has substantial market power (competition from other  
11 airports is unlikely to constrain its charges to a competitive level), we  
12 nevertheless consider that Heathrow has the potential ...”

13 Will you note that they only use the word “potential”. In 3.168 they make it clear that it  
14 was in chapter 5 that they examined the potential. The potential does not mean “great  
15 potential” here.

16 “... Heathrow has the potential to constrain other airports that are substitutes for  
17 Heathrow.”

18 And “substitutes” in the geographic sense.

19 “As already noted, airlines operating out of such other airports compete with  
20 airlines operating from Heathrow for short-haul passengers. Given weaker  
21 network effects and location at other airports relative to Heathrow, this  
22 competition for passengers may ...”

23 Again “may” is a hypothetical word, it does not say “will” –

24 “... may effectively constrain them in terms of their prices and/or the quality or  
25 range of services they offer, even though it does not fully constrain Heathrow.”

26 "3.132 BAA agreed that network airlines operating from Heathrow competed  
27 for short-haul passengers with LCC's operating from airports such as Stansted,  
28 but suggested there was little airports could do to affect this competition. We  
29 do not agree. Airport charges are a cost to airlines and therefore affect the fares  
30 paid by passengers and the quality and range of services provided by the airport  
31 affects both airline costs, and therefore fares, and also potentially the quality of  
32 service that airlines can offer to their passengers. We noted in paragraph 3.3  
33 that if an increase in airport charges results in airlines increasing fares, it is  
34 likely to cause some passengers to switch to other airports, to other methods of

1 transport or not to travel at all. Passengers switching may also be caused by a  
2 reduction in service quality as a result of under-investment by the airport."

3 "3.133 Therefore, although Heathrow has substantial market power, there is  
4 also potential for competition between Heathrow and other airports. Such  
5 competition does not occur at present between BAA's airports; we consider  
6 below whether it would occur if BAA's airports were under separate ownership  
7 and how significant this would be given the existing constraints on BAA airports,  
8 including Heathrow (see Section 5)."

9 So this is not an analysis of extent, it is an identification of potential.

10 In relation to their conclusions, 3.134:

11 "(a) The results of the catchment area analysis for BAA's three London airports  
12 indicate that they are exposed to each other's catchments to a significant degree

13 ...

14 (b) The results of the catchment area analysis also suggests that each of BAA's  
15 three London airports have a higher exposure to each other's catchment area  
16 than they do to the catchment areas of other airports ..."

17 Then you have got the reference to low price sensitivity, which is, in our submission, a very  
18 important fact finding. Then:

19 "(d) Airlines at each of the BAA airports considered that their main competitors  
20 were operating routes from BAA airports. In the case of Heathrow (and to a  
21 slightly lesser extent Gatwick), the main competitors tended to operate from the  
22 same airport but in the case of Stansted and Southampton, the main competitors  
23 tended to operate from other BAA airports. The lesser importance of on-airport  
24 competition at Stansted and Southampton is consistent with the smaller number  
25 of airlines flying from those airports."

26 We have no quarrel with that; that is just factually correct.

27 "(e) A number of airlines operating at Heathrow told us that they did not  
28 consider that any airports (including Gatwick) were substitutes for Heathrow as  
29 other airports did not offer the necessary connecting flights making switching  
30 difficult. As regards terminating passengers, airlines had a range of views, but a  
31 number made the point that Heathrow was preferred to Gatwick by many  
32 passengers, in particular business passengers; some airlines also indicated that  
33 Gatwick yields were higher than at Stansted and one charter airline believed  
34 that there was no realistic substitute for Gatwick."



1 Then you have got two comments on Southampton. So the conclusions do not suggest any  
2 material or high level of substitutability between Stansted and Heathrow. Then there is a  
3 summary of assessment of the individual airports. We do not need to worry about  
4 Edinburgh, Glasgow, Aberdeen, Heathrow at 3.151. There is not a great deal in this section  
5 which alters the analysis because they are simply talking about who is the nearest substitute,  
6 but there are one or two points of interest. 3.152:

7 “Airline evidence suggested that other airports tended not to be good substitutes  
8 for Heathrow because of its role as a hub airport...” [That really reflects what has  
9 been said before].

10 “3.153. Even though airlines tended to suggest that they found it unattractive to  
11 switch services from Heathrow to other airports, other airports can still be  
12 substitutes for passengers (who may have a choice between services from  
13 Heathrow and services from other airports).”

14 Again, a potential only; there is no quantification or analysis of that.

15 THE CHAIRMAN: Sorry, when you say no quantification or analysis, is that not reflective of the  
16 fact that at this stage, 2009, what was being analysed was a situation in which BAA  
17 controlled the three main airports?

18 MR. GREEN: I think the reason they did not conduct the analysis was because it was not  
19 necessary to their reasoning. It would be quite easy to conduct sensitivity analysis of  
20 surveys saying: if you have a choice and on various hypotheses Stansted is performing  
21 better, will you move, what factors affect your movement, what price increases would  
22 influence your movement? Those sorts of surveys are the sort of thing which they do. That  
23 is very routinely conducted to hypothesise how people will react in certain conditional  
24 circumstances. It is a very common form of analysis.

25 THE CHAIRMAN: Yes. One might have considerable reservations about the weight to be  
26 attached to such evidence in particular contexts.

27 MR. GREEN: It is the sort of analysis which the Commission routinely conducts. In a sense, if  
28 you have got to hypothesise what might happen, it is better to do as detailed an analysis as  
29 you can, rather than do nothing and then guess. The Commission does not guess. In  
30 numerous inquiries they do conduct hypothetical analyses, very extensive surveys.

31 THE CHAIRMAN: Yes, thank you.

32 MR. GREEN: 3.154, which effectively is that Stansted is a lesser pressure than Gatwick for  
33 terminators. Gatwick is the main pressure there. 3.155: “In regard to transfer passengers,  
34 substitute hub airports for some passengers may include” some of the Continentals. They

1 do not refer to Stansted but I do not think that really matters in the present context. 3.156:  
2 competition is generally limited at Heathrow for the reasons which they have already given.  
3 Gatwick is dealt with in a couple of paragraphs: 3.157, 3.158.

4 “The closest substitute for Gatwick appears to be Heathrow followed by Stansted.  
5 The catchment analysis indicates that Gatwick is most exposed to Heathrow,  
6 following by Stansted. In addition, passenger surveys from the CAA and BAA  
7 indicated that Heathrow, followed by Stansted, was the most popular alternative  
8 for Gatwick passengers. The airline competitor analysis also suggested that  
9 Heathrow, followed by Stansted and then Luton, were the best alternatives for  
10 Gatwick.”

11 Then there is reference to Southampton. The obvious conclusion: Gatwick, its closest rival  
12 is Heathrow then Stansted.

13 Then Stansted: its closest substitutes are Heathrow and Gatwick.

14 “3.160 ... the evidence mixed on where the stronger constraint might come from.  
15 The exposure analysis suggested that Heathrow was a more important substitute  
16 (at least on the unrestricted basis). [I think that is assuming complete  
17 substitutability.] However, both the CAA and BAA surveys indicated that  
18 Gatwick was a stronger substitute than Heathrow. The CAA survey found that  
19 over 20 per cent of passengers at Stansted considered Gatwick as an alternative,  
20 compared with just over 15 per cent considering Heathrow, and the BAA survey  
21 found that 26 per cent of passengers would have chosen Gatwick if Stansted was  
22 not available, compared with 17 per cent choosing Heathrow. [Again, that is  
23 important in terms of Stansted versus Heathrow.] The airline competitor analysis  
24 suggested that airlines considered that their most important competitors were  
25 located at Gatwick, closely followed by Heathrow, with both airports being more  
26 important locations than Stansted itself...”

27 Then you have got a reference to Luton and then Luton again. Then:

28 “3.163. Overall, the evidence suggests that BAA’s airports, Gatwick and  
29 Heathrow, are Stansted’s closest substitute airports, followed by the non-BAA  
30 airport at Luton. We also note that competition between Stansted and Luton  
31 appears to have constrained Stansted’s prices in the past, but more recently has not  
32 prevented Stansted from imposing a large price increase.”

1 So there is not much there that adds to the previous analysis. Then you have the conclusion  
2 at 3.168 which I have read to you already. It is important because it tells you the difference  
3 between the substitutability analysis and the actual analysis.

4 “However, we recognize there may be external constraints that impact on the  
5 potential for competition even for very close demand substitutes, in particular the  
6 existence of capacity constraints.”

7 What does that tell one about proportionality? It tells one that from their own evidence,  
8 evidence they rely upon in 2011 and which in para.43 of their defence they say they heavily  
9 rely upon because it shows competition going both ways. Obviously you will read it more  
10 carefully than I have had the chance in taking you to it, but it does not support that  
11 conclusion. The conclusion one way is that it is very weak. The other conclusion that  
12 people want Stansted is wrapped up in a couple of paragraphs only in which they talk about  
13 the potential for competition, not the actuality. May I go to my speaking note on this point.

14 THE CHAIRMAN: Sorry, that goes back to the comment I was inviting you to address before.

15 They do not talk about the actuality of competition because they explain that they are  
16 dealing with the world in 2009 where the scope for competition has been constrained by the  
17 fact that BAA owns all three airports.

18 MR. GREEN: No, with respect, they are talking about capacity being the reason why they do not  
19 compete, not common ownership. None of this is linked to common ownership.

20 THE CHAIRMAN: You were saying they are talking about potential for competition, not actual  
21 competition.

22 MR. GREEN: Yes,

23 THE CHAIRMAN: Is not the reason for that that at this stage all three of the airports we are  
24 concerned with are owned by BAA? One would not expect to see actual competitive effects  
25 of great strength.

26 MR. GREEN: The question is: on this analysis what is it that prevents the lack of competition?

27 Of course, this is a static analysis based on the market as it was in 2009, before there was  
28 capacity. So this is saying: in the future, if we have capacity, this very limited degree of  
29 substitutability that we find here will be an irrelevance because you will unleash  
30 competition because they accept that competition is contingent upon there being capacity.  
31 In a sense, this is what this proves. Once capacity exists, for these reasons, for there being  
32 very limited competition, it will evaporate and Pandora’s Box is open.

33 The Commission in 2011 rely upon this and say that the cause of the absence of competition  
34 is common ownership. We simply say that is not correct as a matter of reading this report.

1 They are talking about the fact that there is no competition due to absence of capacity.  
2 They may deduce from that that competition would emerge with the breaking up of  
3 common ownership but that is not what is being stated in this chapter.

4 THE CHAIRMAN: But 3.26 says: "To date there has been no competition between any of  
5 BAA's airports ... this has two important consequences: (a) There can be no direct evidence  
6 of airlines or passengers switching between BAA's airports in response to airport  
7 competition." That seems to be addressing the actual position.

8 MR. GREEN: Yes, the Commission puts the point in that way. Of course, you cannot have  
9 evidence of competition but they say it was because of common ownership and in fact the  
10 analysis shows it was because of capacity constraints. This is what this evidence shows.  
11 They have a confident prediction that in the future there will be capacity, in which case this  
12 analysis is overtaken by the change in the market structure when lots and lots of new  
13 capacity comes into play, and they are then assuming that in 2009 you break up BAA and  
14 you will get competition over the new capacity. That is a fair assumption. It is not one  
15 which translates to 2011.

16 THE CHAIRMAN: Yes, thank you.

17 MR. GREEN: Since the Commission relies so heavily upon the extent to which passengers might  
18 be affected we have done a slightly more detailed analysis at p.42 of the speaking note. In  
19 para.3.132 and 3.3 they identify a number of ways in which passengers might react.

20 THE CHAIRMAN: I am so sorry, where are you in your speaking note?

21 MR. GREEN: Page 42 para.140. I have simply taken the ways in which the Commission says  
22 that competition might occur potentially. Consumer switches to rival airport to obtain lower  
23 fare. Then the second one; consumers decline to travel, consumer travels by train or car,  
24 consumer switches because he/she objects to poor service quality and just analysed each of  
25 those four hypotheses. In relation to lower price, they conducted their own price sensitivity  
26 analysis and it demonstrates a low propensity to switch. That is their conclusion. So that  
27 means that it whittles down the potential for Heathrow to constrain Stansted. If passengers  
28 are largely price insensitive (see para.142) then lower prices at Heathrow, or higher prices at  
29 Stansted, will not induce significant numbers of passengers using Stansted to move to  
30 Heathrow. As to the other passenger responses which might affect competition they were  
31 as follows:

32 Consumer declined to travel. If the passenger simply decides to refrain from travelling  
33 because he or she rejects the price or the quality then divesting Stansted will not affect this  
34 reaction since the Competition Commission assumed that this reaction occurred

1 notwithstanding the possibility of the consumer moving airport. An airport's incentive to  
2 retain a passenger operates quite independently of ownership. The Competition  
3 Commission's finding on price insensitivity also indicates that this is a highly theoretical  
4 possibility. The Competition commission did not have hard evidence on the actual  
5 obduracy levels of passengers.

6 Consumer travels by train or car. If the passenger decides to travel by another means  
7 because he or she rejects the price then divesting Stansted will not affect this reaction since  
8 the Commission assumed that this reaction occurred notwithstanding the possibility of the  
9 consumer moving airport. Again, an airport's incentive to retain a passenger operates quite  
10 independently of ownership. And yet further, the Commission's finding on price  
11 insensitivity also indicates that this is a highly theoretical possibility. Again, no evidence.  
12 Finally, consumer switches because he/she objects to poor service quality. The Competition  
13 Commission posited this as a theoretical possibility, but there is no evidence cited to  
14 support this and the fact that passengers are largely price insensitive strongly suggests that  
15 this is inherently improbable. The main evidence the Competition Commission examined  
16 on consumer preferences was a BAA survey from 2006 which examined which airport  
17 passengers would switch to if the airport of their choice "... had not been available". This  
18 showed that Gatwick was the strongest rival to Heathrow and Stansted. But since it was  
19 predicated upon the first choice airport not being available, as such it tells one nothing about  
20 the reaction of a passenger who had a choice between airports where one offered better  
21 service.

22 MR. ALLAN: Mr. Green, briefly could you just explain to me why price insensitivity, if you  
23 accept that, suggests that service quality insensitivity is inherently improbable?

24 MR. GREEN: I can dig out the paragraphs; I have not got it to hand. There are paragraphs in  
25 which the Commission conclude that quality and price are very closely linked.

26 MR. ALLAN: In terms of passenger reactions?

27 MR. GREEN: Passenger reactions. I accept that in many cases, if the price goes up and you are  
28 not prepared to move, it means you are somewhat indifferent to service quality. It may be  
29 low, it may be high and if the price goes up you are still willing to put up with whatever the  
30 level of service is that is being offered to you.

31 MR. ALLAN: But the proposition is the other way round in a sense. What you are saying is that  
32 the likely impact on the price that the customer pays will be modest at best whereas one  
33 could imagine that a service quality impact is much more tangibly felt by the customer. All  
34 I am asking is --

1 MR. GREEN: Yes, I understand the point you are making which is that there is no automatic  
2 connection between price and service.

3 MR. ALLAN: That is why I wonder why you say it is inherently improbable.

4 MR. GREEN: If you are offered a higher price and there is better service elsewhere, it may well  
5 be the fact that you would switch. It is one of the inducing factors. If you do not switch it  
6 means that you are not looking for service elsewhere. You are saying: even if there is a  
7 higher price, the service, which is superior elsewhere, is not something which attracts me.  
8 If you ask yourself, as a passenger going through Heathrow or Stansted, what is it really  
9 about service that impacts upon you, it is things like queuing time. You do not know what  
10 the queuing time is going to be like at any point in the time or day and there is no analysis  
11 to suggest that I am going to go to Stansted instead of Heathrow, or vice versa, because I  
12 think I will get a couple of minutes' shorter queuing time, or because the toilets are better.  
13 You go through the airport to get through it and get on the plane. It is important that the  
14 Commission itself in Appendix 5.1 (which eventually we will come to) accepts that even  
15 with separate ownership there is going to be no greater incentive to improve service quality.

16 THE CHAIRMAN: It would be helpful if you could, when you eventually get there, explain that.

17 MR. GREEN: Absolutely, yes. If customers are price insensitive, what would be the incentive on  
18 the management to improve service quality? There would not be a great incentive because  
19 you can keep the passenger paying and at an airport even if you have not improved service  
20 quality.

21 THE CHAIRMAN: But if a passenger is relatively price insensitive but strongly service  
22 sensitive, then you will attract the customer by making the service better.

23 MR. GREEN: That is possible.

24 THE CHAIRMAN: When you say people just go to an airport to get on the plane, if you have to  
25 go in and check in however many hours beforehand, there may be a wider range of things:  
26 the shopping experience, whatever else the airport can offer.

27 MR. GREEN: It is a possibility; it is not one which the Commission has analysed or found is  
28 material. I accept there are so many different permutations of the way the market could  
29 operate that it is not something they have analysed. The full extent of the analysis is in  
30 3.132, cross referring back to para.3.3 ,and para.3.3 really just repeats the same thing, the  
31 hypothetical possibility that people might not travel, they might go by rail or ferry or car, or  
32 they may switch. Identifying something as a potential or hypothetical possibility does not  
33 tell you anything about its powers of forcing competition.

1 The point I want to make now (because I am gradually getting towards Appendix 5.1) is  
2 there is no analysis in the 2009 report of why competition absent new capacity would  
3 generate improvement in capex or opex (capital expenditure/operating expenditure). It  
4 comes into 2011 and suddenly it has sprung out of nowhere. It was not identified as an  
5 advantage in 2009.

6 We submit that the reason for that was two-fold. First, because the substitutability analysis  
7 suggested that Heathrow and Stansted were not strong competitors of each other and they  
8 would not be exerting a competitive pressure on each other which would be sufficient to  
9 improve capex performance or opex performance. You can test it this way, particularly in  
10 view of the price sensitivity analysis. If Stansted is inefficient in the way it spends its  
11 money (capital expenditure) and as a result its airport charges are higher - let us take a  
12 figure out of the air - about £30 million a year/£20 million a year, so it therefore passes on  
13 higher charges to airlines, and they then pass on all of that to air passengers, you are going  
14 to get a higher air passenger price. So capital expenditure inefficiency and operating  
15 expenditure inefficiency is simply reflected as a cost, passed on to airlines, passed on to  
16 passengers. If, at the end of the day, there is no price sensitivity and in any event they are  
17 not competing hell for leather with each other, the incentives to be more efficient in terms  
18 of capital expenditure and operating expenditure are very weak. There cannot be any  
19 suggestion that they missed the point in 2009. They give you the reason why the  
20 Competition Commission quite legitimately concluded this was not going to be an issue of  
21 capacity. If you think about it, it was the *raison d'etre* of the decision with new capacity  
22 because you are talking about possibly tens of billions of pounds worth of new capital  
23 expenditure. So it was absolutely the essence of the 2009 decision. It was not identified as  
24 a benefit absent capacity. Suddenly it becomes a benefit in 2011.

25 The reason I make the point now is because it is really to be seen in the context of the  
26 Chapter 3 analysis. There is a reflection of that in Appendix 10.1 para.23 and footnote 7.  
27 Paragraph 23 of Appendix 10.1 says:

28 “Taken together, the substitutability evidence indicates that in the absence of  
29 common ownership, or any other restrictions on competition, Gatwick would be  
30 competing intensely with both Heathrow and Stansted for users. However, as we  
31 explain in Section 4, Heathrow has excess demand for runway slots at all hours of  
32 the day, Gatwick has experienced excess demand through much of the day in  
33 summer, and at Stansted, demand has been at or very close to capacity at peak  
34 times of the day in summer (though Stansted demand has been declining for two

1 years and initial indications for summer 2009 are that some runway capacity will  
2 be available throughout the day). This will naturally limit the extent of  
3 competition during the period when capacity constraints persist, as there are  
4 limited benefits from reducing prices to attract additional traffic when capacity is  
5 constrained. So long as price caps persist at levels the airports can price up to, it  
6 will be economic regulation that determines the average level of airport charges.”

7 Then the footnote:

8 “It will take time for existing capacity constraints to be relaxed: our latest estimates  
9 indicate that the earliest date that a new runway might be delivered at any of the  
10 London airports is 2017. However, relaxation of price control regulation may occur  
11 sooner if the prospect of runway developments influence pricing in advance of  
12 capacity roll-out.”

13 So the Commission’s conclusion at 10.1 is in the section on the divestiture of two airports.  
14 It is that absent capacity there are limited benefits from reducing prices to attract additional  
15 traffic, and it is regulation that ultimately is going to govern us.

16 This brings me to the final point I want to deal with before going (I was going to say  
17 straight) to Appendix 5.1, is the reasons why Stansted had to be sold in addition to Gatwick.  
18 I will take this largely from the speaking note p.29 para.99. Between p.29 and p.36 you will  
19 see just a recitation of paragraph numbers. I am not going to take you to the paragraph  
20 numbers, but what this demonstrates is that in all the places where the Commission  
21 identifies this as an issue, which is in Appendix 10.1 and elsewhere and in paras.10.46 to  
22 10.54 of the Decision itself, the reason why Stansted had to be sold as well as Gatwick was  
23 new capacity. What I have done is to go through every single, solitary paragraph --

24 THE CHAIRMAN: Can you give us those paragraph references again, please?

25 MR. GREEN: If your Lordship goes to para.99 of the note you will see them. It is 10.46 to 10.54  
26 and then Appendix 10.1. Then in order to save time I have simply done a quick potted  
27 history of every paragraph to try to sum up what its essence is, whether it is due to new  
28 capacity or not. It is true to say that dotted amongst the paragraphs we have identified are  
29 references to non-capacity, but our submission is that overwhelmingly, predominantly, the  
30 decision to divest Stansted was new capacity related. I do not think that is surprising in  
31 view of everything else one finds in the decision. Ditto Gatwick.

32 There is, however, a useful paragraph. In the section that you are already in, Appendix  
33 10.1, para.13 the Commission agreed with BAA as to what the framework of analysis might  
34 be. We submit this is still the correct framework of analysis.



1 “Prior to setting out our reasons for requiring the divestiture of both Gatwick and  
2 Stansted, we set out the analytical framework for assessing whether the divestiture  
3 of two airports is required. BAA has argued that we should employ the following  
4 framework: (a) establish the impact on competition of the divestiture of one of  
5 BAA’s London airports; [so now we have Gatwick and so translated to 2011 you  
6 have got Gatwick so you need to assess its impact]; (b) establish whether  
7 continued common ownership of the remaining two airports would be a feature  
8 giving rise to an AEC and, if it would, whether divestiture would be a  
9 proportionate remedy to that AEC [so asking whether you really need Stansted  
10 over and above Gatwick and whether that is proportionate]; and (c) establish  
11 whether regulatory or behavioural remedies would be an effective remedy either  
12 in their own right or in combination with the divestiture of one airport.”

13 So what you are really saying is: do you need to divest Stansted given that Gatwick is now  
14 the strongest competitor to both Heathrow and Stansted and is in separate ownership, and  
15 given that you have got strong regulation? That is the correct framework which we say the  
16 Competition Commission should have examined and should have addressed its mind to.

17 MR ALLAN: But, Mr. Green, we should also note para.14, should we not?

18 MR. GREEN: Yes. Paragraph 14:

19 “We accept the framework proposed by BAA subject to the following caveat. In  
20 applying it, we must allow for the possibility that the impact on competition of the  
21 divestiture of one airport (eg Gatwick) may be affected by whether or not a second  
22 airport (eg Stansted) is also divested. This is because a second divestiture will  
23 change the behaviour of all the London airports with pro-competitive outcomes,  
24 not just that of the two airports whose structural link has been severed. For  
25 example, by increasing the competitive constraints on both Heathrow and  
26 Stansted, the structural separation of Heathrow and Stansted would also increase  
27 the competitive constraints faced by an independent Gatwick and therefore how  
28 aggressively it competes. In the case of the London airports, this effect is likely to  
29 be magnified by its knock-on effect on the need for regulation. If the divestiture  
30 of Stansted were to increase rivalry between all the airports (and we believe it  
31 would), then this would make it more likely that price control regulation could be  
32 removed at Gatwick, increasing the effectiveness of the Gatwick remedy. We take  
33 this into account when considering the impact of the divestiture of the second  
34 airport.”

1 That is true in 2009 when you have got two airports to divest. You have got an option of  
2 one airport, say Gatwick as against BAA in two, or three airports. In 2011 it is no longer  
3 relevant because you have already got Gatwick in separate ownership and the only question  
4 is do we now create a third competitor: Stansted, given that Gatwick is now in separate  
5 ownership? It is no part of the Competition Commission's analysis in 2011 to say that  
6 separating Stansted from Heathrow will, in some way, accentuate competition with  
7 Gatwick.

8 THE CHAIRMAN: That may not be something they say in 2011, we will have to see that, but is  
9 that not what they are saying in para.14?

10 MR. GREEN: Yes.

11 THE CHAIRMAN: They are saying if you have got Heathrow and Stansted both separate and  
12 Gatwick separate, that will create its own competitive dynamic which will increase the  
13 competitive effect on Gatwick?

14 MR. GREEN: Yes, that is right. But that was because of new capacity. That is what they go on  
15 to identify. They say: we need to identify why we divest Gatwick and why we divest  
16 Stansted and we look at both of them, as it were, number one and number two. They  
17 conclude that if you have got new capacity, having three competitors is substantially better  
18 than having two competitors.

19 THE CHAIRMAN: I do not think you have shown us anything yet that indicates that the effect  
20 identified in para.14 here is specifically related to new capacity, but it may be you are going  
21 to show us something which says that.

22 MR. GREEN: That is the purpose of the paragraphs that I have set out in the note. If you analyse  
23 them one by one, there are paragraphs which refer to non-capacity related benefits, but  
24 overwhelmingly in the whole of Appendix 10.1 they are assuming capacity, capacity,  
25 capacity for both the divestiture of Gatwick first and Stansted over and above Gatwick.

26 THE CHAIRMAN: But in paras.5.12 to 5.14 of their report I thought we established that in  
27 Appendix 5.1 they do identify some non-capacity dependent benefits. Looking at para.14  
28 here, this does not seem to draw a distinction between those benefits identified and the  
29 capacity contingent benefits which have been identified. Just as a matter of text it does not  
30 seem to ----

31 MR. GREEN: I agree with that. I am not suggesting otherwise. One looks at the actual analysis.

32 THE CHAIRMAN: Certainly if you show us something that shows that para.14 is qualified, I can  
33 see the point that you are making, but at the moment ----

1 MR. GREEN: I believe para.14 is correct. They had to identify the cumulative effect of divesting  
2 two airports as well as divesting one. They came to the conclusion that two would give you  
3 a commensurately better degree of competition than new capacity. When you analyse what  
4 they then go on to say throughout the whole of 10.1 (which is a longish section) and indeed  
5 in paras.10.46 onwards, the reason why they were going to divest two and not one was  
6 capacity.

7 THE CHAIRMAN: You are going to show us that, but going back to the question that was put to  
8 you shortly after lunch, when it was put to you; is not the trilateral dimension of relevance  
9 here, you said it is irrelevant because Gatwick is now in competition.

10 MR. GREEN: In 2011 the situation is different because you were only talking about the  
11 severance of one airport.

12 THE CHAIRMAN: We are, but if the reasoning in para.14 of Appendix 10.1 is correct, that  
13 would suggest that the additional severance of Stansted now will have a pro-competitive  
14 effect, not just on Heathrow but on Gatwick as well.

15 MR. GREEN: All I can say is in relation to non-capacity benefit that is not the rationale in 2009,  
16 although the principle is correct and they were right to ask the question. But the answer to  
17 the question did not depend upon non-capacity benefits. In 2011 there is no examination of  
18 the accentuated effect on Gatwick of having two as opposed to three. I should limit that in  
19 one respect. In Appendix 5.1 I think there is one illustration which we will come to. I do  
20 not object to the principle; it is simply the conclusion they arrived at as to fact was capacity  
21 related.

22 THE CHAIRMAN: But if you do not object to the principle, when one goes back to the  
23 framework in para.13 of Appendix 10.1 that suggests that when you are looking at 13(a)  
24 and (b) it is relevant if para.14 is not limited to capacity dependent increases in competition.  
25 It would be relevant to take account of the pro-competitive benefits flowing from  
26 competition with Gatwick as well. Is that fair?

27 MR. GREEN: The difficulty is that in 2011 you have Gatwick competing with Heathrow in a  
28 way unconstrained by common ownership, you have Gatwick competing with Stansted, and  
29 vice versa, in a way unconstrained by common ownership. The only part of the triangle  
30 which is left is Heathrow and Stansted. So you are automatically asking the question: what  
31 does that additional severance contribute over and above the severances which have already  
32 occurred?

33 THE CHAIRMAN: Right, but the reasoning in para.14 here seems to be: if you sever Stansted  
34 from Heathrow so that they now start competing with each other, let us suppose that they

1 are competing quite strongly with each other, driving their prices down, that is going to  
2 have an effect on Gatwick prices as well, forcing them down too.

3 MR. GREEN: But there is no evidence of that in the 2009 report. It is a valid question, logically  
4 a valid question to ask and something which analytically ought to be asked. But the  
5 evidence we have taken you to does not suggest that. Although I was not going to go in  
6 detail through Appendix 10.1 perhaps it would help if I do take you to the paragraphs to  
7 show you how the analysis is in fact dependent upon capacity in very large letters. There  
8 are, I accept, some exceptions to that.

9 THE CHAIRMAN: Right. Speaking for myself, I do not have any difficulty looking at the 2009  
10 report and the particular paragraphs you refer to in accepting what you say. But you have  
11 accepted that there are other paragraphs where benefits are identified which are not  
12 contingent upon new capacity. This para.14 in Appendix 10.1 does not draw a distinction  
13 between the two. Therefore, the reasoning would seem to cover that latter category.

14 MR. GREEN: I suspect the answer is to go Appendix 5.1.

15 THE CHAIRMAN: All right.

16 MR. GREEN: That is half an inch backwards in the text in the bundle.

17 THE CHAIRMAN: Just so that we know where you are going with your submission in respect of  
18 the trilateral effect on Gatwick, when we come to the 2011 report are you going to say that  
19 they just do not rely on that at all?

20 MR. GREEN: There is one small illustration in Appendix 5.1 which might be said to be trilateral  
21 and it is simply a matter of going through the benefits.

22 THE CHAIRMAN: I am so sorry, my question was directed solely to 2011; it is not asking you  
23 to go to the 2011 report, and it is not asking you to make it good at the moment. I just want  
24 to know are you, in due course, going to say that the Commission did not rely on any  
25 trilateral impact on Gatwick?

26 MR. GREEN: There is no evidence in 2011 in the relevant parts which suggests that was in their  
27 mind, apart from the one illustration about charge rebalancing.

28 THE CHAIRMAN: Thank you.

29 MR. GREEN: Let us go to Appendix 5.1 which is entitled “The scope for competition between  
30 BAA’s London airport within current constraints”. It is not headed “without capacity”; it is  
31 within the current constraints. The first paragraph says: “In this appendix we set out our  
32 findings on the scope for competition”, and the word scope is relevant because this is their  
33 elaboration from Chapter 5 which concerned the scope for competition “between BAA’s  
34 London airports in the period before new runways are developed and during which the

1 airports remain price capped.” So they are expressly assuming capacity is coming on board  
2 because they are referring to a limited point in time prior to new runways. The reference to  
3 remaining price capped is a reference to the fact that once new capacity comes into play  
4 they assume that the price cap may leave.

5 MR. ALLAN: Sorry, this seems to be going back on what I thought we had established was the  
6 position which was Appendix 5.1 is an assessment not based on anticipated capacity. I  
7 thought that is where we had got to this morning.

8 MR. GREEN: There are two forms of capacity related competition that can arise prior to 2017,  
9 the first runway. You can either have that which is anticipatory but is still within the  
10 constraint because there is no capacity, or you can have competition which arises quite  
11 independent of whether the capacity will come into place or not.

12 MR. ALLAN: I thought we had agreed that Appendix 5.1 was about that second type of --

13 THE CHAIRMAN: That is what I thought.

14 MR. GREEN: The point which is made here is simply - all I have done is read out what they have  
15 said. They are assessing competition up to a point in time. That is what they said.

16 THE CHAIRMAN: The critical point is that they were taking account of the anticipatory effects  
17 of people expecting that new capacity would come around. If you are making that wider  
18 claim, you seem to be going back on what we had established this morning.

19 MR. GREEN: We are getting the CAA documents out and we will come back to you on that.

20 THE CHAIRMAN: All right. At the moment we are to take it, is this right, on your submission  
21 that Appendix 5.1, consistently with your submission this morning, is solely concerned with  
22 competition unrelated to capacity and unrelated to anticipation of capacity?

23 MR. GREEN: Yes, absolutely, but it is time limited.

24 THE CHAIRMAN: Right. That is a different point.

25 MR. GREEN: Yes.

26 THE CHAIRMAN: Yes, thank you.

27 MR. GREEN: It goes on:

28 “In doing so, we focus on the degree to which competition in this period [again,  
29 time limited point] would deliver beneficial outcomes in terms of pricing or  
30 quality improvements rather than on competition’s role in providing the impetus  
31 to overcome capacity and regulatory constraints. This latter aspect is discussed  
32 extensively in Section 5.

33 “(2) BAA’s view is that so long as Heathrow and Gatwick are capacity  
34 constrained and subject to price caps that result in excess demand at these airports,

1                   there can be no scope for material competition on price or quality between any of  
2                   its London airports.”

3                   Then reference to the CAA which I will return to. Then the comment about intense  
4                   competition. Again, I will return to that. But in relation to an important footnote- 2:

5                   “The CAA accepted that continuation of RAB-based price control regulation  
6                   might well serve to limit competition between airports as it would involve the  
7                   regulator effectively determining the price, service quality and investment of  
8                   airports, thus effectively crowding out the potential for competition.”

9                   That is an important point, particularly in relation to their framework of analysis item (3)  
10                  which is whether regulation is doing the job or not. I want to make one thing very clear,  
11                  given their submissions. I am not saying regulation is perfect. That is not our case. We do  
12                  say it is pretty damn good.

13                 THE CHAIRMAN: Sorry, the footnote goes on:

14                   “However, it stated that there was scope, even under the Airports Act, for the  
15                   intensity of economic regulation to be adapted to reflect the degree of competition  
16                   airports face.”

17                  So there seems to be an idea that if you can get effective competition going regulation is  
18                  not necessary presumably because if you can get effective competition that is generally  
19                  better than regulation? The market polices it.

20                 MR. GREEN: Yes. That was the hypothesis in 2009, that if competition emerged that would  
21                  then reduce the need for any regulation and you would just commence to withdraw it. But  
22                  an important point is that under the existing system of price control it is regulation which  
23                  governs competition in relation to service quality, investment and price.

24                 THE CHAIRMAN: If regulation is a second best to effective competition, that is a bad thing.

25                  What the CAA seems to be saying here is: be careful, there is regulation which might crowd  
26                  out effective competition but note that the regulation can be rolled back, allowing effective  
27                  competition to take over.

28                 MR. GREEN: Absolutely, if new capacity comes in.

29                 THE CHAIRMAN: No, no, that is why we keep going back to it. We have focused an awful lot  
30                  of attention on what your submission is.

31                 MR. GREEN: I think this is a different point because in 2011 they recognised that because there  
32                  is no new capacity coming on stream they will not be able to withdraw regulation; it is  
33                  going to persist for a much longer period of time and there is no guarantee that it will be  
34                  withdrawn at all. I see your Lordship’s point. The only point I am making here is that in

1 relation to the framework of analysis which the CC recognises it has to adopt, one of the  
2 questions is will regulation suffice? You have got to ask yourself: does regulation work in  
3 particular in relation to price, service, quality or whatever it is they are talking about. There  
4 is here a statement: the scope for regulation and competition could very well overlap. In  
5 fact, regulation could crowd out competition.

6 THE CHAIRMAN: That would be a bad thing. That seems to me to be the gist of this.

7 MR. GREEN: Yes, but that is not the question for the 2011 judicial review. The question is not  
8 whether regulation is a good or bad thing; it persists. If it persists and it is occupying an  
9 area, perhaps not perfectly, the question then is what would be the supplementary effect of  
10 divesting Stansted over and above regulation, because that is a given?

11 THE CHAIRMAN: Sure. Well, you say it is a given; it is not a given according to this footnote  
12 because the CAA says that the regulation can be rolled back. If the basic model is effective  
13 competition is better than regulation in terms of serving the consumer interest, which I think  
14 you were accepting, then to the extent that you can identify competitive effects, to that  
15 extent it seems that it would be better to allow those competitive effects free range.

16 MR. GREEN: The question you ask is right: when can it be rolled back? When can you roll it  
17 back?

18 THE CHAIRMAN: I accept that is the question.

19 MR. GREEN: If you have got capacity then you can begin to roll back, and the footnote I showed  
20 you earlier suggests possibly even before 2017 they thought there may be rolling back.

21 THE CHAIRMAN: This footnote, at the moment, I do not read as predicated upon the  
22 availability of new runway capacity, partly for the reason that you had accepted up until  
23 now and just accepted again that the predicate for Appendix 5.1 is no expectation of new  
24 runway capacity.

25 MR. GREEN: In 2011 they deal with how long regulation will continue, and that really has got to  
26 be the governing one.

27 THE CHAIRMAN: Perhaps we should wait to see what they say in 2011.

28 MR. GREEN: My only point here is that regulation is accepted as having the ability to crowd out  
29 potential for competition.

30 THE CHAIRMAN: Yes, to which my point is it seems to be a bad thing.

31 MR. GREEN: If it persists into the long run then regulation is going to exist, and in fact one of  
32 the documents we put in the documents bundle was the Department of Transport's  
33 recommendation to enhance regulation. Because there is no new capacity the Commission

1 recognises that regulation will have to continue possibly indefinitely, but certainly for a lot  
2 longer than they imagined in 2009.

3 THE CHAIRMAN: Would that be a convenient moment. We have got to give a five minute  
4 break for the shorthand writer. Very well, five minutes.

5 (Short break)

6 THE CHAIRMAN: Mr. Green, I have been asked to raise a couple of points, really  
7 housekeeping. One is that I have been asked to mention that it may be better in terms of  
8 producing a transcript if you wait for the end of a question from the bench before giving the  
9 answer.

10 MR. GREEN: I am sorry.

11 THE CHAIRMAN: It has not bothered me, but I am told it may make the transcript inaudible. I  
12 am sorry to mention, but I feel that I should.

13 MR. GREEN: No, not at all.

14 THE CHAIRMAN: The second is, just to indicate that the Tribunal is content to sit until five this  
15 evening and start at ten tomorrow in the hope that we may be able to get through it within  
16 the two days. So we will sit to those times. Thank you.

17 MR. GREEN: Appendix 5.1. Just taking it from para.5:

18 “In the process of forming a view on the scope for competition during the  
19 period before new runway capacity is rolled out, we had to decide whether or  
20 not it was appropriate to adopt BAA’s assumption that, under separate  
21 ownership, price caps would persist at levels to which the London airports could  
22 price up. In our provisional findings, we concluded that this was an appropriate  
23 assumption to make because a lack of spare capacity in the short term would  
24 preclude competition from driving prices below these levels or alternatively,  
25 would preclude the relaxation of price control regulation. Despite the impact of  
26 economic downturn on volume, we remain of this view. However, we note that  
27 if the downturn results in more spare capacity than we have envisaged, then the  
28 scope for competition would be larger. We also note that a relaxation of price  
29 control regulation may occur sooner if the prospect of runway developments  
30 influences pricing in advance of capacity roll-out.”

31 So the speed at which regulation may be withdrawn is dependent on the extent to which the  
32 new capacity actually stimulates competition.

33 “Whilst it is difficult to predict all of the dimensions in which airports might  
34 compete during this period, we have identified a number of strategies that



1 separate owners could employ. In doing so, we have recognised that the tools  
2 available to the operator of Heathrow are likely to be different from those  
3 available to the operators of Gatwick and Stansted. This is because Heathrow  
4 will have no spare runway capacity of any significance during this period,  
5 whereas both Gatwick and Stansted are likely to have at least some spare off-  
6 peak runway capacity. In evaluating the scope for competition during this  
7 period, we have therefore considered:

8 (a) in relation to Stansted and Gatwick, competition to fill off-peak slots either  
9 by rebalancing peak/off-peak landing charges or by offering greater off-peak  
10 discounts to individual airlines; and

11 (b) in relation to Heathrow and Gatwick, competition to increase passenger  
12 numbers by rebalancing the landing and per-passenger charge.

13 In relation to all three of BAA's London airports we have also considered:

14 (c) competition for users by improving service quality; and

15 (d) competition via different commercial strategies, eg for higher-value users  
16 such as airlines which convey a higher number of passengers per ATM or those  
17 passengers who contribute disproportionately to retail revenues."

18 They then identify and examine each of these potential benefits in turn. As to "Off-peak  
19 competition between Gatwick and Stansted", I have dealt with this in the speaking note at  
20 para.67 onwards. In these five paragraphs the Commission identifies really a very limited  
21 form of competition. There is no suggestion that this form of competition can arise between  
22 Stansted and Heathrow. It is limited to Gatwick and Stansted and that plainly has  
23 repercussions for 2011.

24 On the Commission's analysis, the capacity of competition was limited. First, the  
25 Commission recognised that both airports were capacity constrained and the only scope for  
26 competition arose in relation to off-peak slots. Secondly, the Commission concluded that  
27 the incentives to compete would be stronger under separate ownership since the operator of  
28 Stansted would no longer consider the effect on Gatwick when contemplating an off-peak  
29 price reduction at its own airport and vice versa. Thirdly, the Commission acknowledges  
30 that if competition led to reduction in off-peaking pricing, this could well be offset by an  
31 increase in peak tariffs restoring average revenue per passenger to price-capped levels.  
32 Accordingly, average returns might well not be reduced. The Commission therefore  
33 identified as the benefit that competition might result in a "... *different distribution of off-  
34 peak vs peak charges and higher capacity utilisation*".

1 The Commission also recognised that off-peak slots might not be attractive to certain  
2 airlines, although it might be to others. Then the Commission accepted, although it is in a  
3 different place, that it might be short term. That is actually in the final decision, and I will  
4 come to that later.

5 The point to be made here is that the Commission itself treats this as a modest form of  
6 competition. They simply moot the possibility that the competition could arise. They have  
7 not examined the nature or the quality of the off-peak slots, it is simply a statement at a  
8 fairly high level of abstraction that there could be competition between Stansted and  
9 Gatwick, not between Stansted and Heathrow.

10 The second category of competition was "Competition to increase passenger numbers at  
11 Heathrow and Gatwick". One needs to read this quite carefully because it is not the most  
12 lucidly clear set of paragraphs. This concerns the possibility that increased competition  
13 could lead to better utilisation of terminal capacity, not runways but terminals, at Heathrow.  
14 Heathrow is runway capacity constrained, but there may, and because there are building  
15 works going on at the moment, at a future point in time be extra terminal capacity. The  
16 hypothesis was that under separate ownership Heathrow might be able to fill the terminal  
17 capacity with more passengers, and it could do this by taking passengers away from  
18 Gatwick and Stansted. There is an element of trilateralism in relation to this illustration,  
19 because it was Heathrow taking away, or possibly taking away, passengers from Stansted  
20 and possibly Gatwick, and there is a paragraph which suggests, albeit in very broad terms,  
21 that maybe Gatwick could do the same thing.

22 Just so that you have the point that I am going to make very clear, the Commission spend  
23 most of their time in paras.12 and onwards identifying obstacles to the realisation of this  
24 benefit. They identify a series of problems and causal obstacles.

25 THE CHAIRMAN: In theory it would work – is this right, I am looking at para.12 – by trying to  
26 get carriers to fill their planes up more?

27 MR. GREEN: That is right.

28 THE CHAIRMAN: So you get more people.

29 MR. GREEN: That is right, more “bums on seats”, exactly. So you do not get more movements  
30 on the runway, you just get more people in the planes. The way in which they are going to  
31 do that is to induce a switching from smaller aircraft to bigger aircraft. Therefore, if you  
32 have got a single landing by a bigger aircraft it can carry more people. Therefore more  
33 people flow through the terminal. That is the theory.

34 THE CHAIRMAN: Where do you get the bigger aircraft?

1 MR. GREEN: That comes in paras.14, 15 and 16. What they are proposing is that there might be  
2 an incentive, if there is single ownership, for a rebalancing between passenger charges and  
3 landing charges. So if you rebalance the charges by upping one and downing the other, you  
4 could possibly create an incentive on the airlines to get bigger aircraft with more  
5 passengers.

6 THE CHAIRMAN: Is it not two things – I am looking at 15(b): you increase load factors on  
7 existing aircraft, or replace with larger aircraft? It does not seem just to be larger aircraft.

8 MR. GREEN: What I will do is take you through it and then pick up the points I make about it.

9 “Whilst Heathrow may be operating at the limit of its runway capacity, it is not  
10 operating at its full terminal capacity. Under separate ownership, we would  
11 expect the operation of Heathrow to and fill its spare terminal capacity by  
12 competing with Gatwick and Stansted for passengers. Given that it cannot  
13 increase the number of ATMs [air traffic movements] that it processes, it could  
14 only increase the number of passengers that used the airport if it could influence  
15 some airlines to carry a higher number of passengers per ATM.

16 The current system of price control regulation enables Heathrow to earn a  
17 maximum amount per passenger. However, within this constraint, Heathrow  
18 can choose to balance landing charges, passenger charges and parking fees in  
19 any way that it sees fit. It would therefore be open to Heathrow to lower the  
20 per-passenger charge and offset this with an increase in the landing charge to  
21 induce airlines to carry more passengers per ATM. In doing so, it could  
22 potentially attract some passenger traffic away from Stansted and/or Gatwick  
23 and increase runway utilisation whilst lowering fares.

24 BAA has argued that changing pricing structures at Heathrow would be unlikely  
25 to result in a material increase in passenger volumes because airlines have  
26 control of the slots and the airport has a limited ability to influence airline  
27 decisions on how the slots could be used. BAA also argued that even if it were  
28 shown that changing pricing structures would have an impact upon usage, there  
29 is no basis for linking the pricing structures that prevail to common ownership,  
30 In particular, BAA argued that tariff restructuring at Heathrow and Gatwick  
31 might result in an increase in demand at Stansted, not a decrease as we believed  
32 possible.

33 We accept it is difficult to predict how responsive airlines would be to changes  
34 in the balance of charges. However, we believe that incentives to lower

1 passenger charges (and increase landing charges) would be stronger under  
2 separate ownership, so long as ...”

3 Then they set out three assumptions:

4 “(a) airlines are currently profit-maximising in respect of fares and fleet  
5 capacity, and they have some market power;

6 (b) the number of passengers per ATM can be expanded either, for example,  
7 by increasing load factors on existing aircraft or by airlines upgrading their  
8 fleets or by the replacement of routes operated by smaller aircraft with those  
9 operated by larger aircraft; and

10 (c) airports are currently optimising in respect of the tariffs they currently  
11 charge – in other words, they are currently optimally offsetting the benefits  
12 from lowering passenger charges with any costs (including costs of negotiating  
13 with airlines on this) from doing so;  
14 then, in principle ...”

15 so that is on the basis of those three assumptions –

16 “... we would expect the operator of Heathrow to have a higher incentive to  
17 compete for passengers by lowering passenger charges (and increasing landing  
18 charges) under separate ownership than under common ownership.

19 Whether this happens in practice will depend on the ability of airlines to react to  
20 changes in the balance of charges (the assumption in paragraph 15(b) above).

21 The higher the incremental costs of expanding the number of passengers per  
22 ATM, the smaller the volume effect of lowering the passenger charge will be  
23 and the smaller the incentive an airport will have to rebalance charges. In the  
24 very short term, an airline’s ability to increase passengers per ATM may be  
25 confined to the scope to increase load factors on existing aircraft, which may  
26 not be possible under yield management systems (although at Heathrow load  
27 factors currently average 73 per cent and have therefore some scope for  
28 increases).”

29 So their first point is that this may not be possible at all by reference to existing yield  
30 management systems, which are basically the systems whereby the aircraft sets the revenue  
31 that it wishes to obtain from a plane – let us say it is going to be profitable at 80 per cent  
32 capacity and it adjusts its prices accordingly, depending upon when you buy and how you  
33 buy. So it may not be any incentive to do anything over and above that if your yield  
34 management system does not encourage it.

1 Then they go on to say:

2 “Over time, routes operated by smaller aircraft may be replaced by routes  
3 operated by larger aircraft and airlines may also deploy larger aircraft over  
4 existing routes. Their incentives to do this will depend on the benefits obtained  
5 from passing lower passenger charges through to fares compared with the costs  
6 of operating the larger aircraft necessary to accommodate larger passenger  
7 numbers per ATM. One airline told us that if charges were to fall by 50 per  
8 cent at one of the airports at which it was based, it would replace the smaller  
9 aircraft it had there with larger ones as a priority to take advantage of increased  
10 volume potential through lower fare offerings. In the context of our Stansted  
11 Q5 review, we were told that easyJet had recently renegotiated an aircraft order  
12 so as to be able to carry more passengers per flight at congested airports,  
13 replacing a request for A319 aircraft with larger A320s.”

14 There is no suggestion that that was actually due to any form of rebalancing.

15 “The scope for competition in this way will also depend on the nature and scale  
16 of any other constraints that prevent an operator from rebalancing charges.”

17 That is the 15(c) assumption.

18 “If airlines are resistant to rebalancing charges, then separate ownership may  
19 not have a significant effect on the structure of tariffs even if incentives changed  
20 in favour of rebalancing charges. Indeed, we have been told by BAA that the  
21 airlines are resistant to increasing landing charges and reducing passenger  
22 charges because this would shift more volume risk on to the airlines. It could  
23 be the case that airline negotiating power would therefore limit the potential for  
24 competition for passengers in this way. Indeed BAA does not appear to have  
25 discounted passenger charges in favour of higher landing fees when (albeit  
26 weaker) incentives to do so exist under common ownership; and this suggests  
27 that there may be other factors which are preventing it from doing so, which  
28 may limit the extent to which competition of this nature might deliver benefits.  
29 Nevertheless, the higher incentive to reduce per passenger charges eventually  
30 feed through into negotiations between the airlines and the airport even if the  
31 effect on charges, utilisation and fees is modest.”

32 They then turn to Gatwick.

33 “We consider that there is some scope for Gatwick to compete with Heathrow  
34 and Stansted in this way so long as Gatwick continues to experience excess

1 demand. Compared with Heathrow, Gatwick has fewer slots subject to excess  
2 demand and higher load factors suggesting less to be gained from competition  
3 along this dimension. However, there is a higher proportion of small aircraft  
4 operating slots, which suggests more to be gained from this kind of  
5 competition.”

6 If you jump to para.75 of our speaking note, if you extract from these paragraphs the  
7 obstacles which the CC itself has identified, you will see why they have concluded it is a  
8 pretty modest form of benefit. Paragraph 75: the CC’s analysis of these assumptions  
9 highlights the hypothetical and improbable nature of the potential benefit. It identified five  
10 limits or obstacles to the scope for such competition to emerge which related to:

- 11 (1) the constraints imposed upon airlines by yield managements systems which could  
12 prevent airlines from responding at all and certainly not timeously;
- 13 (2) the actual extent to which per passenger charges might be reduced and landing  
14 charges increased and whether this then made it economically sensible for an airline to incur  
15 the substantial cost of switching to a larger aircraft (so as to enable the airline to benefit  
16 economically from the lower passenger charges);
- 17 (3) the fact that rebalancing would shift ‘volume risk’ to airlines which they were  
18 unwilling to accept;
- 19 (4) observable conduct on the part of BAA in circumstances where there already  
20 existed incentives to rebalance charges but where BAA had not done so; and
- 21 (5) the fact that Heathrow would be terminal capacity constrained for some years to  
22 come, and that is because of the redevelopment at terminal 2, so that is a temporary  
23 problem, but in the context of a review going until 2017 it may be a significant one.

24 What does this lead to? It leads to the fact that the Commission has identified a possibility,  
25 it has identified the obstacles which would need to be overcome and the assumptions which  
26 would need to be overcome for it to be material. It has not examined then each of those  
27 obstacles to say, “We have conducted a survey of the airlines and we have given them  
28 hypotheses based upon different charges and we have examined their reactions”. They have  
29 simply identified the obstacles and said, “Well, yes, it is a possibility”. I rely heavily upon  
30 para.17 where the CC accepts that because airlines might be resistant to increasing landing  
31 charges because of the shift in volume risk, and they would exercise a degree of negotiating  
32 power, it would limit the potential for competition for passengers in this way. I rely also on  
33 the CC’s acknowledgement that BAA was already under this incentive to rebalance charges,  
34 albeit that it describes it as weaker, but it did not do so. In those circumstances, it is hard to

1 do anything other than limit the value of this benefit to something close to *de minimis*. It is  
2 a hypothetical benefit which might exist, but it is not one of any serious magnitude.  
3 We have got so far off-peak competition between Gatwick and Stansted, we have got  
4 rebalancing which, if you like, is a bit of triangulation, and then you have got service  
5 quality in para.19. This is their case on service quality competition.

6 “There may also be scope for separate ownership to stimulate improvements in  
7 the overall quality of service offered. As we have noted, airlines operating from  
8 different BAA London airports compete with each other and we would expect  
9 separately owned airports to be more responsive to airline views than BAA, as a  
10 common owner, has been. We consider that good service quality is often a  
11 matter of good management and organisation rather than the result of spending  
12 large amounts of money ...”

13 and then the next words are important –

14 “... (this is relevant as even separately owned price-capped airports do not  
15 necessarily have the incentives to spend on improving service quality, except to  
16 achieve SQR targets).”

17 Those are the regulatory service quality targets. That is very important because they are  
18 recognising that there is no necessary incentive which could be brought around by  
19 divestiture on the management to spend any additional penny on service improvements  
20 which do not achieve SQR targets.

21 Just taking the words as they stand, what the Commission is saying is that there is a  
22 theoretical possibility for service quality improvement, but because of the regulatory  
23 system, the service quality requirement (SQR) were not even saying there is anything over  
24 and above SQR which would create an incentive on Stansted or Heathrow to spend money  
25 on service.

26 THE CHAIRMAN: Is that not what they are saying in that sentence:

27 “Rivalry in the provision of service quality would supplement the effect of SQR  
28 targets, which are inevitably imperfect substitutes for competition.”

29 So they seem to be saying expressly that there is an additional effect.

30 MR. GREEN: The point I was about to make was they are inconsistent. One, they say there is no  
31 necessary link over and above SQRs, and then they say that what they are really saying is  
32 that if there is anything it would have to supplement SQRs, which I suppose is logical, but it  
33 tells you nothing about the scope for that actual competition, and it is not something they  
34 have examined. One of the reasons why I took you at some length to chapter 3 is to actually

1 demonstrate that the evidence for service quality improvements between Stansted and  
2 Heathrow is extremely limited. They have not conducted an analysis of service quality  
3 competition between the two.

4 THE CHAIRMAN: How do the service quality regulation targets operate? Can you just tell us?

5 MR. GREEN: That is what I was going to take you to next. The point that we make in relation to  
6 that is that service quality requirements historically have been imposed at Heathrow but not  
7 at Stansted. They were introduced for the first time following the 2008 review. This is in  
8 my speaking note ----

9 THE CHAIRMAN: Sorry, when you say “the 2008 review”, what do you mean?

10 MR. GREEN: In the year before the main decision here the Competition Commission conducted  
11 a review of service charges at Stansted known as the “Q5 Review”. There are a number of  
12 paragraphs here where the commission cross-refer back to their own Q5 analysis. I will  
13 take you through the speaking note, and I can certainly take you to it. The review is in the  
14 bundle. In the speaking note at para.85 ----

15 MR. BEARD: I am sorry, this may not matter, but we are not sure that the Q5 report is in the  
16 bundles at all.

17 MR. GREEN: Yes, it is attached to our reply and skeleton. It was served as an appendix to that.

18 THE CHAIRMAN: Which bundle is it in?

19 MR. GREEN: Bundle D, tab 2.

20 THE CHAIRMAN: I have not read this document. Is there a description of how the service  
21 quality requirements regime works?

22 MR. GREEN: In the speaking note I have given a brief summary. It is a penal regime. They  
23 have set various standards which they have to meet, which are measurable. If they fail to  
24 meet it, they are subject to a penalty.

25 THE CHAIRMAN: What are the standards? Are we told what they are?

26 MR. GREEN: If it helps, I will get someone to just dig out the relevant paragraph and you can  
27 see a list of what they look like.

28 THE CHAIRMAN: That would be helpful in due course.

29 MR. GREEN: The point I wish to make is that the Competition Commission investigated with  
30 the Civil Aviation Authority in 2008 – they introduced an SQR regime – service quality  
31 regulation – and they did not re-examine it in 2009, they did not re-examine it in 2011. The  
32 evidence suggests that it has been successful. There is no evidence in 2011 that there was a  
33 recurring service quality problem that regulation does not meet. I accept entirely the  
34 possibility that regulation is not perfect, it is not our point. The fact that the SQR regime is



1 acknowledged by the CC, that there is no incentive on separate management to do anything  
2 other than comply with the SQR regime, strongly indicates that this is an exceedingly  
3 modest benefit. I will just go to the note. Certainly, without analysis of the extent to which  
4 you can get the supplementary effect, there is really very little – one paragraph – which  
5 adds anything to the suggestion that it is a significant benefit.

6 MR. ALLAN: Is it the case that that paragraph is based on the CAA's evidence summarised in  
7 para.3? Is that the way that the report works?

8 MR. GREEN: Not really. There is a cross-reference back, certainly in the later report, they  
9 simply say that they have examined it in the past.

10 MR. ALLAN: It is 3(c) that talks to quality of service, and that does seem to be the only evidence  
11 base. It may be that is more a question for Mr. Beard, but there is ----

12 MR. GREEN: I was intending to take you at some length through 2008 report, but it so dull. It  
13 may be that I need to take you through it a little bit.

14 MR. ALLAN: Cruel and unusual punishment!

15 THE CHAIRMAN: My basic understanding, just so that you know, is that if you have imposed  
16 by regulation service quality requirements, they will set certain minimum levels below  
17 which there was a concern that airports were falling before, but that does not eliminate the  
18 possibility for competition. If airports are in a situation where they have to compete to  
19 attract customers, that would not remove the incentive for them to compete to attract  
20 customers in terms of service quality.

21 MR. GREEN: It is not actually what is said here. This is the problem. We are entitled to say to  
22 you, given this is a judicial review, that this is a single paragraph, it is upon this paragraph  
23 that they rest their case on service quality. There is very little elsewhere in the reports  
24 which addresses service, if anything, service competition absent new capacity. It is an  
25 admission, which we rely upon, that even separately owned price capped airports do not  
26 necessarily have the incentive to spend on improved service quality except to achieve SQR  
27 targets. The inference one draws from that is that if there is scope for competition to work  
28 its magic it is going to be extremely limited. It would be correct theoretically to say that,  
29 given the words in parenthesis, the only way in which it can exert any pressure is by  
30 supplementation. The inference that one draws from the words in parenthesis is that it is  
31 very, very limited in scope. This is meant to be a substantial benefit. This is all we have on  
32 service quality.

1 MR. ALLAN: I think, just to be sure we understand correctly, what the parenthetical wording  
2 says is that there is not an incentive to spend on improving. There may be ways which do  
3 not involve expenditure.

4 MR. GREEN: Not related to money.

5 MR. ALLAN: Doing the job better, in other words.

6 MR. GREEN: Yes, to which one says ----

7 MR. ALLAN: It is also right to say, is it not, that the sentence, “Rivalry in the provision of  
8 service quality would supplement” is not qualified with any adverb as to scale of  
9 supplements. They can be small or large.

10 MR. GREEN: If the Competition Commission is seeking to rely upon this to justify breaking us  
11 up, then they ought to have examined this by a survey asking airports what non-cost related  
12 effort management incentive could you make which is going to be generated over and  
13 beyond regulation and why? Why would you do this? What is the advantage? What is it  
14 about breaking up Stansted, which generates this supplementary incentive? This is a  
15 paragraph which is meant to give clear, substantial and significant benefit. This is a  
16 paragraph they rely upon to justify a forced sale – this and a bit of charge rebalancing and  
17 something which occurs between Gatwick and Stansted and not Heathrow and Stansted.

18 THE CHAIRMAN: I follow that and the force of it, but just on the words in parenthesis, they say  
19 “do not necessarily have incentive to spend”.

20 MR. GREEN: Yes, might do.

21 THE CHAIRMAN: In some situations they may do. If you are competing for customers, if it is  
22 the case - I appreciate you say they did not have an evidence base for this- but if it is the  
23 case that service quality is an important way that you attract customers and you make  
24 money out of customers, then you will have an incentive to spend on improving service  
25 quality, will you not?

26 MR. GREEN: The conclusion here is consistent with chapter 3 which suggests that the  
27 competitive constraints are weak between the two for the reasons we have gone over. It  
28 cannot really be that, because that is not strong enough. They do not say it is strong  
29 enough. They hypothesise in chapter 3 where they say, “We do not examine the scope of  
30 it”.

31 MR. ALLAN: At the moment I am just trying to understand the meaning of the bit in brackets,  
32 just what it means and what you submit it means.

33 MR. GREEN: If I can just take you to our speaking note because it describes the SQR regime and  
34 explains why it is a really very powerful incentive to do a lot in relation to service quality.

1 MR. ALLAN: If, even doing that pursuant to the SQR regime, you can see that if you did a bit  
2 more, and spent some more money, you would get better passenger flows then it would be  
3 economically rational to spend the additional money to get the passenger flows, would it  
4 not?

5 MR. GREEN: Yes, in a way, which, sir, you have identified, it imposes a series causal  
6 hypotheses, “if, if, if”.

7 MR. ALLAN: I agree, but I was just trying to see whether one should attach weight to the word  
8 “necessarily”?

9 MR. GREEN: Yes, that is logically correct.

10 MR. ALLAN: Thank you.

11 MR. GREEN: Going to the speaking note, para.85, the analysis of service quality in the CC’s  
12 2009 report relies heavily upon the earlier 2008 Q5 report. The CC’s own detailed analysis  
13 of service at Stansted in the 2008 review shows that the scope for improved service  
14 competition flowing from divestiture was very limited.

15 In 2009, the CC recognised that the prevailing regulatory system already regulated quality  
16 by the imposition of SQR targets.

17 The CC had identified prior to 2008 the existence of service quality problems, had  
18 examined the nature and extent of the problems and had identified the remedial steps  
19 needed to be taken to eradicate these issues.

20 The details of the measures then introduced by the Competition Commission and Civil  
21 Aviation Authority to address service quality issues are as follows.

22 Service quality relates to such matters as security, queue waiting time, availability of air  
23 bridges, lifts, track transit system, escalators and stands.

24 The CC recommended that the CAA introduce an SQR regime at Stansted and that this be  
25 backed by penalties. The CC recommended (i) the specific standards to be applied, (ii) that  
26 penalties for non-compliance should be severe and based upon 5 to 10 per cent of the  
27 revenue from airport charges, and (iii) no bonuses should be allowed for meeting the SQR.

28 Appendix N of the 2008 Q5 review contained a detailed analysis of service quality at  
29 Stansted (it is 38 pages long).

30 The focus of the 2009 report is on Heathrow and Gatwick, not Stansted. There is only  
31 limited reference to Stansted (see para.7.99), which records that an SQR system would be  
32 introduced for Stansted. The regime came into force on 1<sup>st</sup> April 2009, and therefore would  
33 have been in force as at the date of the 2009 report.

1 It is also apparent that the SQR regime was one that was capable of being tightened as  
2 experience grew of its operation: see, for example, the 2009 report, paras.7.96 and 97 for  
3 the Commission’s detailed recommendations on how the SQR regime could be improved at  
4 Heathrow and Gatwick and on the CAA’s implementation measures. As a stand-alone,  
5 single paragraph, it is an important part of the rationale justifying divestiture. We submit  
6 that it is so hypothetical and so remote as to attract pretty much a zero value. It is true to  
7 say hypothetically or theoretically there could be some scope, but the thrust of the  
8 paragraph is that it is *de minimis* or so small as to be unmeasurable.

9 It is not really a criticism of the CC in 2009, because again this was not really necessary to  
10 investigate for the purpose of their decision. It is very much a criticism we make in 2011,  
11 where they just simply repeat this paragraph.

12 If you turn over, all that is left is “Scope for competition through differing commercial  
13 strategies between Heathrow, Gatwick and Stansted”. This is pretty high falutin’ stuff.

14 “There is also scope ...”

15 One always sees the word “scope”. There is no analysis, it is just “potential” –

16 “... for competition through differing commercial strategies, such as focusing  
17 on specific types of traffic. For example, there is scope for airports to compete  
18 for particularly high-value users, such as airlines which convey higher numbers  
19 of passengers per ATM or passengers that contribute disproportionately to retail  
20 revenues.”

21 That seems to be not much more than passenger rebalancing. It seems to me, if you are  
22 competing to convey higher numbers of passengers per ATM, it is pretty much the same  
23 thing.

24 “The CAA told us that the volume of passengers was not the only dimension on  
25 which airports could compete – different passengers had different values  
26 according to, for example, what they spent in retail, so that would be another  
27 dimension of competition.

28 New management teams may find other ways to compete for valuable users.

29 Generally, we would expect that the different management strategies and  
30 techniques that would arise through separate ownership would tend to increase  
31 innovation and efficiency.”

32 There are two ways in which management is incentivised. One is competition, which takes  
33 you to the chapter 3 analysis. The second is regulation. If it is regulation that they are  
34 referring to here – no, they are not referring to regulation, they say there is scope for

1 competition through different strategies. If competition between Stansted and Heathrow is  
2 weak the pressure to do these things is also very weak.

3 THE CHAIRMAN: Conversely, if it is strong, the pressure to do them is strong.

4 MR. GREEN: Yes, and with new capacity it was strong.

5 THE CHAIRMAN: At the moment we are taking this is predicated on no new capacity.

6 MR. GREEN: On no new capacity. In a judicial review, when this becomes the justification for  
7 the divestiture as opposed to just simply surplusage, to simply say that there is scope for  
8 something, we submit is not enough. If you are going to justify the breaking up of a major  
9 trading corporation, it is fine in 2009 when it is not central to the analysis, but in 2011 when  
10 it becomes central you would have expected to see some evaluation of the scope for these  
11 benefits.

12 MR. ALLAN: But I thought in 2011 they have actual evidence of what has been happening at  
13 Gatwick.

14 MR. GREEN: I will show you that.

15 MR. ALLAN: We need to bear that in mind because ----

16 MR. GREEN: Absolutely, and it is very, very thin.

17 THE CHAIRMAN: Let us leave the submission on that until we come to that.

18 MR. GREEN: Then you have got, finally, "The impact of the next quinquennium", which is the  
19 five year review:

20 "Under the current regulatory system, short-term incentives to compete would  
21 become weaker towards the end of a quinquennium because the benefits of  
22 attracting additional passengers disappear at the beginning of the next one. This  
23 applies to passenger numbers as well as to the commercial revenues that they  
24 generate. This would tend to limit the incentives for airports to compete with  
25 one another to fill off-peak slots, or to compete for passengers and for high-  
26 value customers in the later years of a quinquennium.

27 However, it would not remove them altogether. Indeed, this disincentive  
28 applies to BAA under common ownership yet its behaviour suggests that it has  
29 faced incentives to increase passenger numbers and increase retail spend in its  
30 airports. Moreover, if there is an expectation of deregulation or of a longer  
31 period between regulatory reviews, then the effect on incentives to compete  
32 may be significantly less."

33 Then there is a summary.

1 THE CHAIRMAN: Can I just ask, a quinquennium, is that because regulatory review is on a five  
2 year rolling basis?

3 MR. GREEN: Yes.

4 "Taken together, we consider that even in the presence of capacity constraints  
5 and price cap regulation, there is scope for service quality competition and  
6 modest price competition between BAA's London airports."

7 2011 has some additional reasoning in it, but you have seen from their 2011 decision that  
8 they are quite emphatic that Appendix 5.1 is still the basic premise upon which they rely.  
9 So when you sum up this as the starting point for a justification to force Stansted to be sold,  
10 we submit it adds up to a very small row of beans. We have got a little bit of off-peak  
11 competition between Gatwick and Stansted. They have not analysed the quality of the off-  
12 peak competition or how long it will be continued for, given that the assumption of the  
13 entire report is that demand is constantly on the increase. It is a point which I make more  
14 fully in relation to another ground. But even that excess capacity, that spare capacity is  
15 going to be eroded away fairly quickly. Part of it is recession-based. That is likely to  
16 disappear. The quality, given it is off-peak, it is the least usable slot and therefore it has  
17 lowest economic value. There you are, it is off-peak. It is between Gatwick and Stansted.  
18 Then you have got charge rebalancing which is extremely hypothetical for the reasons the  
19 Commission itself identifies, and you have got service competition. Adam Smith says  
20 different management will all do different things. That is it, total. That is the analysis  
21 which the Commission relies upon as its bedrock for the 2011 decision, and it says this  
22 analysis does not change. A little bit of updating, but it relies heavily upon this.

23 We are entitled to say to you that if this is insufficient as a justification for divesting  
24 Stansted, we are entitled to have the decision set aside. The Commission says this is  
25 substantial, clear ----

26 THE CHAIRMAN: Can I just ask: how does that relate to the previous challenge to the 2009  
27 report?

28 MR. GREEN: We did not challenge this because at the time we were assuming new capacity.  
29 That occurred within weeks of the new government coming in in May 2010, there or  
30 thereabouts. The first challenge was in 2009, a year earlier.

31 THE CHAIRMAN: Thank you.

32 MR. GREEN: That is the sum total: scope, service quality, modest price competition. Our  
33 objection, as I have emphasised, is not that they did not do further work in 2009. We  
34 reserved that for the 2011 update. It was understandable that they did not do the work then

1 for the reasons we have discussed at some length. That is the context of the 2011 analysis.  
2 It is appropriate to go to that now. We find it in the 2011 Decision in bundle A. Most of  
3 the 2011 report is irrelevant for present purposes because it is devoted to dismissing various  
4 grounds as an MCC. The only ground which they accepted as a material change was that  
5 concerned with the change in government policy.

6 THE CHAIRMAN: Just so as I am clear; you do not complain about them not treating the other  
7 things as MCCs?

8 MR. GREEN: There is one, one of our other grounds. All the other grounds are much more  
9 limited than ground one, but there is one that we say they have misanalysed and should be  
10 an MCC but that is concerned with reduction of profitability at Stansted. That is quite a  
11 discrete issue. It is not related to this.

12 THE CHAIRMAN: I see. All right. That is point 5(d), is that right, in this report?

13 MR. GREEN: Yes, in the report.

14 THE CHAIRMAN: You say that they were wrong not to treat that as an MCC?

15 MR. GREEN: Yes. The analysis of individual benefits starts at para.44 of Appendix A. Here  
16 they say: "We look next at the customer benefits that would flow from divestiture." They  
17 refer first of all to Appendix 10.1 of the 2009 report:

18 "... we explained why the divestiture of two London airports was necessary. As  
19 set out in paragraph 10.105 of the 2009 report, in our guidance we note the  
20 advantages of competitive rivalry".

21 Then they just extol the virtues of competition.

22 "46. In the particular circumstances of the original inquiry, the CAA told us that  
23 the combination of capacity constraints and regulation would not necessarily or  
24 materially limit the scope for additional competition between BAA's London  
25 airports. In particular, it submitted that there could be competition in terms of  
26 [and they cite what you have already seen and we are busy analysing that and we  
27 will come back to that tomorrow.]

28 "47. In paragraphs 10.107 and 10.109 of the 2009 report we explained that it was  
29 difficult to quantify the benefits of divestiture in this case:

30 'Calculation of the quantum of divestiture benefits is inevitably complex  
31 and subject to uncertainty. Competition is a dynamic and inherently  
32 uncertain process, and it is therefore difficult to anticipate precisely how  
33 competition between the airports will benefit customers following  
34 divestiture. The uncertainty is exacerbated in this case by the current

1 absence of competition between BAA airports and the shortage of direct  
2 comparators from which to extrapolate the size of the benefits that could  
3 be expected to result from competition between BAA's airports in the  
4 South-East and between Edinburgh and Glasgow ... It is not possible to  
5 quantify the benefits of divesting the London airports given the more  
6 complex interactions and the existing regulatory regime.'

7 "48. The difficulty of quantifying the likely benefits of divestiture remains an  
8 issue, particularly for airports in the South-East. Despite this difficulty, we  
9 consider that it is likely that there are significant benefits of competition which  
10 will accrue from divestiture of Stansted given the divestiture of Gatwick. These  
11 benefits may not only accrue at Stansted but also at Heathrow and Gatwick as  
12 rivalry between airports intensifies following divestiture of Stansted. These  
13 benefits may be considered under the following headings."

14 You will see there is service quality which is one we have just looked at. We have then got  
15 capital cost efficiency, operating costs, comparative competition, price competition. So  
16 there were three new benefits. There is no explanation for why these benefits --

17 THE CHAIRMAN: Just on para.48 the second sentence: "These benefits may not only accrue at  
18 Stansted but also at Heathrow and Gatwick as rivalry between airports intensifies following  
19 divestiture of Stansted" that seems to be an echo of para.14 in Appendix 10.1.

20 MR. GREEN: Perhaps, but if it were a serious point one would expect to see some sort of  
21 analysis. Again, from a judicial review perspective it is all very well to make an assertion  
22 that something might be better off, but the Competition Commission works on an evidence-  
23 based approach. If, in entirely new circumstances of a radical change in the economic  
24 structure or the market, they are going to make assertions, before BAA is broken up and  
25 told to sell an airport it is entitled to know that there is strong evidential support for  
26 something. We submit it really is just not good enough for them to make assertions that do  
27 not have evidence. That is a criticism we make of an enormous amount of the analysis.  
28 There is a great deal of just assertion. A traditional judicial review says that the court can  
29 supervise the decision maker to ensure that there is evidence to support an assertion. There  
30 is no mystery about that; it is standard case law.

31 THE CHAIRMAN: Yes.

32 MR. GREEN: So taking these individual benefits one by one:

33 "Likely areas of benefit beginning in the near future."



1 "51. There are several types of long-term benefit that are likely to start to accrue  
2 in the near future following divestiture of Stansted."

3 "Service quality improvements."

4 They then cite 5.1. You will remember that service quality, para.19, was an analysis in the  
5 period up to the first runway, 2017. It was not an analysis of what would happen between  
6 2009 and 2039. There was a 22 year gap. So they set out para.19:

7 "53. Following the sale of Gatwick, there has been a period of a year and a half of  
8 independent ownership from BAA. Whilst this is too short a period from which to  
9 draw definitive conclusions about the full extent of benefits deriving from the  
10 independent ownership of Gatwick,"

11 So their first point is that it is too short a period of time from which to draw definitive  
12 conclusions. So the best they can get is something which is indicative. So they have  
13 already downgraded the relevance of Gatwick in separate ownership.

14 "... there is already significant evidence that a number of service-led initiatives  
15 over and above those expected when Gatwick was part of BAA have been  
16 introduced. During this review, we received a submission from Gatwick that  
17 identified a number of the initiatives that it had taken - see paragraph 53 of the  
18 main text."

19 THE CHAIRMAN: Can you just help me: Gatwick was divested when?

20 MR. GREEN: December 2009.

21 THE CHAIRMAN: Thank you. And the date of this report?

22 MR. GREEN: This is July 2011.

23 "Gatwick also told us about feedback from passengers. There had been a 50 per  
24 cent reduction in complaints about security, and this issue had fallen out of the top  
25 five areas of complaints. The ratio of complaints to compliments had reduced  
26 from 17:1 in 2009 to 5:1 by the summer of 2010, and the total volume of  
27 complaints had fallen by more than 15 per cent and compliments had increased by  
28 150 per cent. Complaints from passengers with reduced mobility had fallen by 60  
29 per cent and a new service provider had been introduced.

30 "55. The Service Quality Rebate (SQR) scheme applies to Gatwick (see the 2009  
31 report paragraph 7.87). Monthly statistics showed that under BAA ownership,  
32 Gatwick failed to meet its security queue targets in the four months July to  
33 October 2009 in both North and South terminals. Gatwick achieved the same  
34 targets in every month since January 2010 (the month after the change of

1 ownership), including the equivalent July to October period in 2010. This  
2 provides evidence of service quality improvements following a change of  
3 ownership.

4 “56. In addition, the CAA said that it had seen examples of how Gatwick’s  
5 different approaches had benefited customers.

6 “57. We found that there is evidence since Gatwick came under separate  
7 ownership of actions to improve the customer experience and encourage airlines  
8 to use Gatwick. This evidence is encouraging; although Gatwick has not been  
9 under separate ownership for very long, the evidence is in line with what we  
10 would expect to develop over time. We would expect benefits from service  
11 quality improvements to continue at Gatwick and to intensify with further  
12 competitive rivalry and also to arise at Stansted once it is independently owned.”

13 I will come back to the illogicality of that statement in a moment. There is absolutely no  
14 reason why the very first time in which you expect to see service quality improvements is  
15 once it is separated from Heathrow when it is accepted that Gatwick is a stronger  
16 competitor to Stansted than Heathrow is.

17 “These benefits are difficult to quantify reliably, but in aggregate over the  
18 assessment period we consider that the present value of these service  
19 improvements will be substantial.”

20 So what are they saying? They are saying: we repeat what we said in para.19 which  
21 includes the paragraph that even separately-owned price-capped airports do not necessarily  
22 have incentives to spend on improved service quality; they refer to Gatwick but they ignore  
23 the fact that SQRs were introduced for the first time at Stansted and that in 2009 the  
24 Commission identified improvements in performance and there is no evidence of an extant  
25 problem at Stansted in relation to service quality. There is no analysis of whether the  
26 improvement at Gatwick is in fact simply due to different SQR regimes, or the SQR regime.  
27 They point out that there may be an improvement since ownership, but there is no evidence  
28 that it is causally connected by ownership. That is a leap in logic, particularly when the  
29 SQR regime is operating and it is perfectly reasonable to assume that they are simply  
30 responding to the SQR regime. It is a leap in logic to say that Gatwick has improved  
31 because of separate ownership, albeit that it is a fact that it might have improved after  
32 separate ownership, and it is an equally bigger leap in logic to translate that to Stansted,  
33 given that Stansted has been subject, for the first time, to an SQR regime which has every  
34 evidence of being very effective.

1 If the Competition Commission is going to use this now, in 2011, as a justification for  
2 breaking up BAA it is simply unfair not to conduct a proper analysis of the SQR regime at  
3 Stansted to see whether or not it is performing well, or whether regulation leaves any  
4 material scope for improvements. The Commission is also bound to ask itself and re-  
5 examine whether competition between Stansted and Heathrow would be such as to generate  
6 the supplementary effect. It is not enough just to make an assertion. This time it really  
7 matters. It did not matter last time. Now it really matters. Service is their first point; it is  
8 the first point on the list. There is no additional analysis. They have simply got some  
9 comments in, some suggestions from Gatwick, but no analysis of what happens at Stansted  
10 itself.

11 MR ALLAN: Sorry, can we just go back on the point about the SQR regime and the comparative  
12 performance. I think I understood you correctly to say that there was no evidence to  
13 correlate any change in that respect to change in ownership. But para.55 at least says that  
14 prior to the change in ownership Gatwick failed to meet its SQR targets whereas following  
15 change in ownership it met those targets. Are you saying that those factors may be  
16 explained by other things? In which case what are they, or what are you telling me?

17 MR. GREEN: The Competition Commission has not explained what they are. They have simply  
18 said that there was a difference before and after. The SQR regime is one which, certainly so  
19 far as Stansted is concerned, is penal. It is a penal regime, and they accept in relation to  
20 Stansted, because they say so in para.52, that there is no incentive on the management  
21 necessarily over and above the SQR.

22 THE CHAIRMAN: Will not the SQR regime be penal at Gatwick?

23 MR. GREEN: I am not certain they are the same. It was a tailor-made regime for Stansted. They  
24 introduced reviews of the regime during the quinquennial reviews and so there is perhaps a  
25 period of catch up. I can certainly check that. I do not think they are necessarily the same  
26 at the two airports.

27 THE CHAIRMAN: I thought the whole point of having a regulatory system to try to control  
28 service quality would be that there would be penalties attached if you failed to meet the  
29 standards set out.

30 MR. GREEN: There are different ways, there are different targets, different levels of penalty.  
31 There was a big argument, for example, between the CAA and the Competition  
32 Commission as to whether or not there should be bonuses for meeting the targets.

33 THE CHAIRMAN: Is not the underlying essence of such a regime that there will be some  
34 monetary penalty either in the form of, you will be charged a penalty, or in the form of, you

1 will not get some monetary benefit that you would otherwise get if you fail to meet the  
2 standards?

3 MR. GREEN: Yes, but there is no evidence here ----

4 THE CHAIRMAN: I am putting to you now that that seems to me likely to be the nature of any  
5 extra ----

6 MR. GREEN: I do not know if that is true or not for Gatwick or Heathrow.

7 THE CHAIRMAN: If you are making a point that a false comparison is drawn with Gatwick in  
8 para.55, you had better make that good.

9 MR. GREEN: I do not know that that is true or not. The point I am making is that you cannot  
10 simply assume that whatever happens at Gatwick will necessarily be relevant to Stansted.  
11 Stansted has its own very particular regime, which was tailor-made for Stansted and related  
12 to particular problems which have been identified at Stansted, which may or may not be the  
13 same as at Gatwick. The evidence in 2009 was that this was working. The Commission  
14 have not conducted any additional analysis of the problem at Stansted. So there is no  
15 suggestion there is an extant service problem at all. In those circumstances, given that the  
16 basic premise is that competition supplements regulation, our submission is that if this is  
17 now used as justification to divest Stansted, to break up BAA, then there should have been a  
18 proper analysis. This is inadequate evidence.

19 THE CHAIRMAN: I understand that you make the submission that it is inadequate evidence, but  
20 if one looks at para.55, does it not suggest that BAA was previously arguably insufficiently  
21 responsive to an SQR regime, and suggests that one might draw the inference that what has  
22 made the difference where you have separate ownership of Gatwick from December 2009 is  
23 an attempt to compete on service standards?

24 MR. GREEN: Certainly that is the inference they seek to draw, but we submit it is not a logical  
25 read-across to Stansted. Whatever happens at Gatwick is not necessarily the same as would  
26 happen at Stansted.

27 THE CHAIRMAN: Yes, thank you.

28 MR. GREEN: Can I have a moment? (After a pause) I will not take up time checking something  
29 at the moment. I have not found the reference I was looking for. I will come back to it, if I  
30 may, at an appropriate moment in the future.

31 The second benefit which is identified is capital expenditure. This was not identified as a  
32 benefit in 2009, as you have seen. We submit that there was very good reason for that.  
33 Again, I have made my submissions about this. Capital expenditure, if it is conducted  
34 inefficiently, becomes a cost, and therefore the extent to which it could ever be subject to

1 competition is governed by the substitutability analysis in chapter 3. If there is weak  
2 competition between Stansted and Heathrow, it is not at all apparent how that pressure  
3 would be significant enough to have a material impact on capex performance. That was the  
4 logic of 2009. In our submission, that is why there is no reference in Appendix 5.1.  
5 Competition is not going to generate, on the CC's own analysis, sufficient pressure to  
6 improve capex. Again, I accept this may not be an absolute, but if it is going to be  
7 sufficient, if Heathrow is going to constrain capex at Stansted and vice versa then the  
8 Commission should have conducted an analysis of its extent, because capex also is  
9 regulated and capex has been regulated at Stansted by the CAA, and they identified benefits  
10 and certain inefficiencies in 2008. They introduced a detailed regime for regulation and  
11 they imposed caps on capex, capital expenditure, which reflected an external consultant's  
12 view of the extent to which there may be an inefficiency. There is no finding of continued  
13 capital expenditure inefficiency in 2009 or 2011.  
14 Now they say that it is a sufficient justification of an adequate magnitude to warrant  
15 divestiture, and they do so on a very limited range of evidence.

16 THE CHAIRMAN: They seem to be referring to a paragraph in the main report, the 2009 report,  
17 10.110.

18 MR. GREEN: Yes, that is right.

19 THE CHAIRMAN: I am not sure that we have looked at that.

20 MR. GREEN: It is on p.10-19.

21 THE CHAIRMAN: Can we just read that, so that we have clearly in mind what is being talked  
22 about. (After a pause) When they say, "In the course of our recent review of airport  
23 charges at Stansted", is that Q5?

24 MR. GREEN: Yes.

25 THE CHAIRMAN: (After a pause) When you say that they had not identified ----

26 MR. GREEN: That is in Appendix 5.1.

27 THE CHAIRMAN: Yes, but it is in the main report?

28 MR. GREEN: It is in the main report.

29 THE CHAIRMAN: So one might be critical that they did not group everything relevant in 5.1 but  
30 it is there.

31 MR. GREEN: They are not saying that competition could necessarily generate this, absent new  
32 capacity, the implication is that it is regulation that brings about improvements in capex.

33 THE CHAIRMAN: No, I do not think that is what they are saying here:

1                   “... these illustrative savings would be delivered more quickly and to a much  
2                   fuller extent in a competitive environment and that airports under separate  
3                   ownership would have stronger incentives ...”

4 MR. GREEN: Let us just be clear about this. This is in a paragraph which is dealing with  
5                   implication to new capacity. So, for example, when they refer in (a) to:

6                   “potential savings of £500 million on the development of a second runway ...”  
7                   that is a capacity related benefit. The same for (b):

8                   “... capital savings resulting from the adoption of different parameters for the  
9                   terminal building and airfields.”

10                  Then (c) is £25 to £40 million over five years in SG1. SG1 is the capital expenditure prior  
11                  to new capacity. It may be anticipation, but it is not dependent upon new capacity. So (c) is  
12                  something which they purport to rely upon. Then (d) is the paragraph they rely upon for  
13                  opex:

14                  “In relation to operating expenditure, scope for reducing relative pay costs by at  
15                  least 20 per cent and scope for reducing absenteeism and its related costs.”

16                  So for capex what we are now talking about ----

17 THE CHAIRMAN: Just on (d), that seems not to be dependent on a new runway.

18 MR. GREEN: SG1 is their capital expenditure programme prior to new runways.

19 THE CHAIRMAN: Yes, that is (c), but I am saying that the same point seems to apply to (d) – is  
20                  that fair?

21 MR. GREEN: Yes. Those were not identified in 5.1 as of sufficient magnitude or value to be  
22                  worthy of mention as benefits absent – you are quite right when you talk about competitive  
23                  environment, but certainly (a) and (b) are capacity related; (c) and (d) might not be.

24 THE CHAIRMAN: I am not quite sure of the point you are making there. I can see it might have  
25                  been more helpful for Appendix 5.1 to include to everything so that you could look at it in  
26                  one place. If you are looking for a hierarchy of significance one might think actually in the  
27                  text of the report itself it is a bit more important.

28 MR. GREEN: No, with respect, they expressly refer to 5.1 as the place where they do the  
29                  analysis, but they do not refer to it as being elsewhere. In chapter 5 that is the place where  
30                  the analysis goes.

31                  The reference to a much fuller extent and competitive environment, certainly it is fair to say  
32                  that it could cover both capacity and non-capacity, but in the context of this whole section,  
33                  in our submission, they are essentially referring to capacity based competition. I accept that  
34                  you could read it as suggesting that it would be non-capacity based competition, but we do

1 say that if it had been of any significant materiality it would be in 5.1 because that is where  
2 they, themselves, say they have conducted the analysis.

3 What we have done is to take each of those two to see precisely what the scope for it is. If  
4 these are the benefits which they say could arise then one has got to say, what is the scope  
5 for competition between Stansted and Heathrow beyond regulation in relation to these  
6 matters?

7 THE CHAIRMAN: Right. So having read 10.110, we go back to the 2011 report, and what do  
8 you want to emphasise there?

9 MR. GREEN: I have got a number of points to make about it. The first point is, as a matter of  
10 reasoning, they should have explained why it was not a sufficiently material benefit, even if  
11 it may have been a benefit. If it was not a sufficiently material benefit in 2009 why has it  
12 suddenly becomes a benefit in 2011? In fact, the reasons for it being a benefit were less  
13 than they were in 2009.

14 THE CHAIRMAN: I am sorry, I am not following that. They have said in para.10.110 that it  
15 would be a benefit.

16 MR. GREEN: They have said it is a benefit. If we go back to that paragraph. Where they say “to  
17 a much fuller extent in a competitive environment”, I take your point that it could be  
18 referring to (a), (b), (c) and (d). In my submission, if you read the whole of section 10 in  
19 the round it is primarily, predominantly, concerned with new capacity.

20 THE CHAIRMAN: You have already said (c) and (d) are not.

21 MR. GREEN: May not be related, yes. The question is how material are they? When it says, “to  
22 a much fuller extent in a competitive environment”, absolutely in relation to ----

23 THE CHAIRMAN: I quite understand you have got an argument on materiality, but the only  
24 reason I interrupted you was that you said that they should have explained why something  
25 that was not a benefit and not thought to be a benefit in 2009 was thought to be one in 2011.  
26 I was only making a textual point. They did say that it was a benefit in 2009.

27 MR. GREEN: I accept that.

28 THE CHAIRMAN: I will calm down; you are not making a submission that contradicts the text.

29 MR. GREEN: My point is that if it had been of sufficient importance to really matter it would be  
30 in 5.1 and it was not.

31 THE CHAIRMAN: Right.

32 MR. GREEN: Because that is where they did the analysis of this issue in the absence of new  
33 capacity. The reason why that is logical is because in 2011 the point should be weaker than  
34 it was in 2009. That is because if there were to be capex and opex improvements in 2009

1 from competition, the Commission was contemplating two divestitures which would bring it  
2 about: Gatwick and Stansted, whereas in 2011 we have got Gatwick exerting a competitive  
3 pressure. So we are concerned only with the incremental effects of Stansted. It is therefore,  
4 by definition, a weaker point in 2011 than in 2009.

5 THE CHAIRMAN: I am so sorry, I am not sure that I followed that last point and that is my fault  
6 because I was not listening carefully.

7 MR. GREEN: I am sorry. In my submission, the point is a weaker one by definition in 2011  
8 compared to 2009. That is because in 2009, if it was a significant benefit, the divestitures  
9 would generate capex advantages, it would be because of the dual effect of two divestitures:  
10 Gatwick and Stansted. Yet it was not in 5.1. In 2011 you have got Gatwick, so, if there are  
11 benefits they come from the pressure which Gatwick exerts. Therefore, the question is what  
12 is the incremental effect of Stansted over and above Gatwick? It is a weaker prospect in  
13 2011, mechanistically, than it was in 2009.

14 THE CHAIRMAN: I am not sure I am following that. It is as strong for Stansted in 2011 as it  
15 was 2009?

16 MR. GREEN: No, because you have got Gatwick exerting the pressure on Stansted. Gatwick is  
17 the strongest rival to Stansted and it is to Heathrow. Stansted is a second level competitor.  
18 So now, if there are capex advantages they already exist in the marketplace; Gatwick is  
19 pressurising Stansted and it is pressurising Heathrow. Therefore the question now is only  
20 with Stansted standing behind Gatwick what supplementary effect does it exert over the  
21 marketplace as it exists today, with regulation and Gatwick?

22 THE CHAIRMAN: But para.10.110 is looking at the overall beneficial effect on capex and opex  
23 if you have divestment of both Gatwick and Stansted.

24 MR. GREEN: Yes.

25 THE CHAIRMAN: That is what it seems to be looking at. I take your point that one has  
26 achieved divestment of Gatwick already, but the way this is put here suggests that there is  
27 still scope for an additional benefit to accrue if one divests Stansted as well.

28 MR. GREEN: The question is what is the scope of that? Given the reduction in materiality, the  
29 benefits, there is no dispute between us and the Commission that the benefit side of the  
30 proportionality equation has gone right down.

31 THE CHAIRMAN: I am trying to evaluate your submission that the effect is weaker in 2011 than  
32 in 2009. I am not sure that I am following why one would expect the incremental effect of  
33 divesting Stansted on top of Gatwick would be any weaker in 2011 than in 2009.



1 MR. GREEN: If you look at the scope of what has been contemplated in 10.110 you are looking  
2 at Gatwick and Stansted operating upon SG2 as well as SG1, which is all the new runway  
3 capacity. In 2011 you are stripping out (a) and (b).

4 THE CHAIRMAN: Is that the point that you are making?

5 MR. GREEN: Yes, that is the point.

6 THE CHAIRMAN: If one were just concentrating on (c) and (d) there would not be any reason,  
7 would there, for thinking that there would be a material difference in the incremental effect  
8 of divesting Stansted along with Gatwick?

9 MR. GREEN: In 2009 of course Gatwick was not exerting pressure on SG1.

10 THE CHAIRMAN: Right, so that is a way of saying that the effect would be greater in 2011?

11 MR. GREEN: No, in 2011 you have got that pressure.

12 THE CHAIRMAN: So the pressure has got bigger to produce these capex results?

13 MR. GREEN: The pressure is there.

14 THE CHAIRMAN: I thought you just said the pressure was not there in 2009? I am slowing up  
15 at ten to 5 so it is probably my fault, but I thought that you were saying that there was no  
16 pressure in 2009.

17 MR. GREEN: Because they had not divested it.

18 THE CHAIRMAN: Right. So if this is a benefit contingent on pressure, if you are right, then that  
19 benefit gets greater in 2011.

20 MR. GREEN: You have got a much smaller target. In 2009 you had this vast target of capex for  
21 SG1, SG2, you have opex during existing capacity and over future infrastructure, and two  
22 airports to create independent pressure to work its magic on that array of activity. In 2011  
23 the scale of activity has shrunk enormously to suggested savings of £5 million to £8 million  
24 a year in capex and for up to £40 million over Q5. And a little bit of operating expenditure  
25 relating to pay and absenteeism. You have got Gatwick working on that, and you have got  
26 regulation of those issues.

27 MR. ALLAN: But this is the same as the para.14 question, is it not? You have the same question  
28 the Commission had to consider in 2009, which is what is the incremental value of divesting  
29 Stansted over and above the divestment of Gatwick, which is the same question now on a  
30 different evidence base about scale. But the fact that Gatwick has already been divested  
31 does not alter the nature of the consideration.

32 MR. GREEN: I do not disagree with that. I think it boils down to this, and maybe we are at cross  
33 purposes, that it was never considered sufficiently important to put it into Appendix 5.1.  
34 We are entitled to say that is where the exercise is- you have that point.

1 MR. ALLAN: Yes.

2 MR. GREEN: Point two is in 2011 the scale of this capex and opex advantage has massively  
3 reduced. All the new capacity capex has gone, all the new capacity opex has gone. You are  
4 left with £25 million to £40 million over five years. So that is £5 million to £8 million a  
5 year, and some absenteeism and pay. The Commission should have asked itself this: in  
6 relation to those matters we have got regulation which we accept is rigorous (it may not be  
7 perfect) and we have got Gatwick, hat is the incremental effect of divesting Stansted given  
8 that we have already concluded that it is a weak competitor anyway? That is what it  
9 ultimately boils down to. Those are the questions they said they had to ask themselves in  
10 Appendix 10.1, those three questions.

11 MR. ALLAN: Yes, thank you.

12 MR. GREEN: In terms of the reduction in scale between the two analyses, 2009 and 2011, it is  
13 not easy to get an exact handle on this, but it is important to show what the scale of the  
14 benefit is now. We dealt with this in the speaking note at 172.

15 THE CHAIRMAN: Are we still talking about capex?

16 MR. GREEN: I am back to capex now. The difference in scale between the capex contemplated  
17 in 2009 and that relevant to the 2011 reassessment is in fact vast. The capex envisaged by  
18 successive rounds of new capacity extending until 2030 was likely to run into more than ten  
19 billion pounds. The new capacity was estimated to create a 47 per cent increase in the  
20 runway capacity of the London airports by 2030, ie commercial activity equating to the  
21 creation of one and a half new airports.

22 In 2011 the Competition Commission was left with such residual capex as would occur  
23 under a status quo of no new capacity. We now have the Competition Commission  
24 devoting 11 paragraphs to capex which is the expansion of this subparagraph of 10.110.  
25 Paragraph 10.110 refers to the 2008 review during which SG2 projected capex played a  
26 major role. In circumstances in which the Competition Commission had found that very  
27 substantial capital expenditure was contemplated on a rolling basis over 30 years, there will,  
28 by definition, be enormous scope for competition to arise between airports in separate  
29 ownership over the manner and efficiency with which they invest in capital projects. In the  
30 2009 Report the Competition Commission gave various estimates of capex for SG2. For  
31 example, the Competition Commission referred to BAA's own projected costs for a 50  
32 million person terminal and runway development of £2.3 billion. The Competition  
33 Commission referred to a further report which had concluded that the cost of SG2 might be

1 as high as £2.3 billion but could be reduced to £1.8 billion. By way of contrast, the  
2 Competition Commission noted that the capital expenditure for SG1 would be £85 million.  
3 The Competition Commission does not give figures for Heathrow capex. New Heathrow  
4 capex over the new capacity would have been larger than at Stansted. Providing a precise  
5 figure is neither possible nor necessary. As a rough indication, if one doubles Stansted  
6 capex, assumes that there would be (at least) one further round of new capacity post 2017  
7 (the Competition Commission's own assumption) and then takes into account inflation, the  
8 2009 capex assumption could easily exceed £10 billion.

9 When that is taken out of the equation, the scope of relevant capex in 2011 is a fraction. It  
10 would appear that in so far as one can get a handle on it at all (and this may be an  
11 exaggeration) it may be as small as 5 per cent. That is the figure which we have calculated  
12 in footnote 117.

13 So we are dealing with something which may be only a twentieth of the scope in 2011  
14 compared to 2009. It is very hard to get the exact figure and perhaps one does not need to  
15 be precise, but it is a tiny fraction of the scope of the benefit which was going to be realised  
16 in 2009 by multiple divestitures.

17 THE CHAIRMAN: Right, but that is one twentieth of what seem to be very big figures.

18 MR. GREEN: That is why the figures given in 10.110, those are the total figures. One is looking  
19 at what the level of capex and efficiency might be, so it is a fraction of that. That is why in  
20 10.110 they talk about a potential saving of 10 to 16 per cent equivalent to £25 million to  
21 £40 million over Q5, which is £5 million to £8 million a year. If you just factor that into the  
22 Chapter 3 analysis, assuming that there is £5 million to £8 million of inefficiency a year,  
23 and that is then fed into increased charges which is then fed into increased passenger fares,  
24 it is perfectly possible to try to analyse what effect that would have on the scope for  
25 competition, if any. Indeed, the price sensitivity analysis suggests that it might be *de*  
26 *minimis* or non-existent. It is a very important point because they are talking about how  
27 will competition improve capex? Their Chapter 3 analysis suggests that there is not going  
28 to be a significant impact, or at least they have not proven that it will be. We are entitled to  
29 say to you that their own reasoning casts a very serious doubt upon whether competition, in  
30 other words simply divesting Stansted, is going to do anything material beyond regulation  
31 and beyond the impact of Gatwick. That is the crux of this issue in relation to capex: where  
32 does the Competition Commission say that over and above regulation plus Gatwick there is  
33 going to be an effect which is sufficiently material to justify the conclusion they should  
34 break up BAA?

1 | THE CHAIRMAN: Yes, thank you. Is that a convenient moment?

2 | MR. GREEN: Yes, it is.

3 | THE CHAIRMAN: Very well. We will resume at 10 o'clock tomorrow.

4 | (Adjourned until 10.00 a.m. on Tuesday 6<sup>th</sup> December 2011)