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IN THE COMPETITION

Case No. 1185/6/8/11

APPEAL TRIBUNAL

Victoria House
Bloomsbury Place
London WC1A.2EB

Wednesday, 7th 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 THREE

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. Beard.

2 MR. BEARD: Sir, members of the Tribunal, in providing the submissions on behalf of

3 Competition Commission, I will deal with some brief legal submissions to start off with and
4 then move on to work through the grounds and pick up the various criticisms that have been
5 levelled at the Commission's approach by Mr. Green and BAA.

6 If I may, I would invite you to take up the first authorities bundle, volume 1, and turn to tab
7 1. I am, of course, aware that the Tribunal knows about these relevant provisions, but given
8 various of the points that were made it is perhaps just important to take a step back and see
9 how it is that we got to the position we did in 2009 and 2011 under the relevant statutory
10 tests. Can we start at s.134(1) of the Enterprise Act. This is the central provision that says:

11 "The Commission shall, on a market investigation reference, decide whether any
12 feature, or combination of features, of each relevant market prevents, restricts or
13 distorts competition in connection with the supply or acquisition of any goods or
14 services in the United Kingdom or a part of the United Kingdom."

15 So if a feature, or combination of them, prevent, restrict or distort competition then there is
16 an AEC in relation to that feature or features. That is described in sub-section (2). If it has
17 identified any AEC, then under s.134(4) it is under a positive duty to decide whether any
18 action should be taken under s.138 to remedy, mitigate or prevent the AEC, or any
19 detrimental effect on customers, and, in addition, to consider whether there should be any
20 recommendation to others to take action. Generally a recommendation to others in these
21 market investigation reports tends to be a recommendation to government, and indeed that
22 is what happened here.

23 The other point to note in s.134 is 134(6) which refers to the scope of the remedial duty:

24 "In deciding the questions mentioned in subsection (4) ...

25 - so the remedial duty section:

26 "... the Commission shall, in particular, have regard to the need to achieve as
27 comprehensive a solution as is reasonable and practicable to the adverse effect on
28 competition and any detrimental effects on customers so far as resulting from the
29 adverse effect on competition."

30 So what you have is a duty to consider whether or not to take any steps to remedy, mitigate
31 or prevent the adverse effect on competition, and in doing so you must look at the most
32 reasonable and practicable solution to obtain as comprehensive a solution as possible.

33 It is also important in considering this to look at 138 itself, which is just over the page in the
34 tab. 138(1):

1 “Subsection (2) applies where a report of the Commission has been prepared and
2 published under section 136 within the period ...”

3 that is the case here:

4 “... and contains the decision that there is one or more than one adverse effect on
5 competition.”

6 So if you have AECs then s.138 bites. Then:

7 “(2) The Commission shall, in relation to each adverse effect on competition,
8 take such action under section 159 or 161 as it considers to be reasonable and
9 practicable –

10 (a) to remedy, mitigate or prevent the adverse effect on competition concerned;
11 and

12 (b) to remedy, mitigate or prevent any detrimental effects on customers so far
13 as they have resulted from, or may be expected to result from, [that AEC].”

14 We do not have s.159 or s.161 in the bundle, but what they do is provide the Competition
15 Commission with power to accept either final undertakings or to make final orders which
16 may be, in very broad form. Just for your notes, the powers that the Commission have are
17 set out in schedule 8 to the Enterprise Act and they plainly involve a range of powers,
18 including divestments.

19 What is important to bear in mind is that under s.138(2), the Commission "shall" take action
20 if there is an AEC. So it is under a duty to do so.

21 Of course, going back to 134(4), the Commission does have the power in appropriate
22 circumstances to decide that no action should be taken in relation to the remedying of an
23 AEC. Clearly, the emphasis in terms of the duty under s.138(2) is that it shall remedy
24 where you have an AEC. That means that it will be a very rare case that no remedy shall be
25 put in place where an AEC has been identified. That is, after all, the purpose of this regime.
26 It provides an independent scheme, set aside from ordinary political intervention, to ensure
27 that markets work better for customers and consumers in the UK. It means that competition
28 law is not just limited to the prohibitions in the Competition Act 1998 or specific regulatory
29 schemes for particular utility industries that exist in telecoms and water and energy and in
30 relation to airports. It goes further. This is a regime intended to ensure that the structures of
31 markets can be scrutinised and the flaws remedied.

32 With that in mind, we then move to the crucial provision for the purposes of the 2011
33 decision, which is s.138(3). As I have said, there are duties under s.138(2) to take remedial
34 action to deal with AECs, and (3) says:

1 “The decisions of the Commission under subsection (2) shall be consistent with its
2 decisions as included in its report by virtue of section 134(4) ...”

3 so that is the basic provision –

4 “... unless there has been a material change of circumstances since the preparation
5 of the report or the Commission otherwise has a special reason for deciding
6 differently.”

7 So the duties to remedy that exist under 138(2) and 134(4) do not just dissipate because of
8 the lapse of time that has happened in this particular due to the fact that an unsuccessful
9 challenge was brought by BAA to the 2009 report. The basic structure is that there were
10 AECs found in the report and there continues to be a duty to remedy them, unless it is
11 shown – unless the Commission is satisfied – that there has been a material change of
12 circumstance or some other special reason. “Special reason” really does not apply here.
13 It might actually, outside the confines of this Tribunal, give rise to a little bit of
14 mystification about what is going on here, because, after all, BAA did unsuccessfully
15 challenge the divestment of Stansted. It failed. The only reason we are here is because the
16 process of dealing with that took so long. It feels slightly odd that a system should enable
17 someone to take litigation and then have a second go, but the Competition Commission did
18 not stand on ceremony about that, the Competition Commission specifically, in December
19 2010, said, “The challenges are at an end, we are conscientious to the potential of s.138(3)”
20 and it went out to consultation on these matters.

21 THE CHAIRMAN: Sorry, what was the date when they went out to consultation?

22 MR. BEARD: I think it was 10th December 2010. The end of the Court of Appeal challenge was
23 in November 2010.

24 THE CHAIRMAN: So Court of Appeal judgment November 2010.

25 MR. BEARD: Yes, we set out the time line in our defence, if that is of assistance just as a point
26 of reference.

27 THE CHAIRMAN: Yes, just give me the paragraph number.

28 MR. BEARD: The relevant story is in paras.5 through to 7 of the defence. I am sorry, it was
29 November 2010, the Competition Commission’s news release saying that the CC invites
30 submissions.

31 THE CHAIRMAN: Thank you.

32 MR. BEARD: In the context of these proceedings, what is particularly important to recall is that
33 BAA’s common ownership of Heathrow, Stansted and Gatwick was an AEC finding in the
34 2009 report in respect of which remedies were required and that remained the case

1 subsequently. In that context it is also worth remembering that in 2009 it had been
2 specifically concluded that only the divestment of three airports, one Scottish and two of the
3 London airports, so that each of the London airports was separately owned, was the
4 effective way – the only effective way – of remedying the common ownership AECs, and
5 that lesser measures such as some form of internal management control or separation would
6 not suffice. Given the findings that had been made pursuant to s.138(3), the Competition
7 Commission was still in 2011 obliged to pursue those same remedies unless the exception
8 under s.138(3) applied, ie if there was a material change of circumstance?

9 We have seen what the relevant suggested material changes of circumstance were. There
10 were, in fact, five of them, four from BAA and one from Unite. The four from BAA were
11 government policy change in relation to runways, intense competition arising in relation to
12 low cost carriers, Heathrow's position as a hub airport and the significant fall in Stansted's
13 profitability. They are set out, just for your notes, in para.36 of the 2011 decision. Only
14 two of those are really at issue, the first and the fourth.

15 It is just worth noting what Unite said. Unite also said that the sale of Gatwick was, in fact,
16 a material change of circumstance. It said the sale had not resulted in any discernible
17 change to the level of competition but that Gatwick was now in a far more precarious
18 financial position at a time of recession.

19 There is a degree of irony about the MCCs that were being put forward, in the sense that
20 Unite was coming forward and saying, "Actually, contrary to what BAA were suggesting,
21 Gatwick is not providing any competitive impact at all".

22 Just for completeness, I would note that in the 2011 report at para.25 there is a discussion
23 about how the CC considers material change of circumstance – whether materiality is a low
24 threshold or high threshold. It does not matter for these purposes, no challenge is brought,
25 but because this is the first ----

26 THE CHAIRMAN: Challenge is brought to the decision on decline in profitability.

27 MR. BEARD: Sorry, the point I am making, and I do not mean to oblique, is simply that in
28 relation to whether or not there was an argument that actually any change of circumstance
29 that was material – i.e. very small – counted as an MCC and therefore you had to revisit all
30 the remedies. The Competition Commission said, "That is not the way we necessarily see
31 things, either materiality is a low threshold but we have a residual discretion, if there is a
32 material change of circumstance, whether to revisit and change the remedies that we have
33 put in place", or materiality is actually a much higher threshold, and if materiality is met

1 then we automatically would change the remedial consequences. That is spelt out in
2 para.25 of the report.

3 The only reason I raise it is because it is a slight wrinkle in terms of interpretation. It does
4 not arise in these proceedings as a challenge, but since it is the first time that this provision
5 has ever come before a Tribunal, I think the Tribunal just needs to be alive to the fact that
6 that interpretative question was considered and dealt with.

7 Where we were was that unless the CC had identified good reasons for deciding that there
8 was a material change of circumstance, justifying a departure from the 2009 remedies, those
9 remedies had to be adhered to. That clearly meant that if anyone like BAA – in fact,
10 particularly BAA given the focus of the report – considered that there were material
11 changes of circumstance justifying a departure from those remedial conclusions it was
12 appropriate for it to set out all of its relevant arguments to the Competition Commission and
13 provide whatever evidence was within its control or otherwise for the Commission’s
14 consideration. We are not here talking about a situation where we are dealing with the
15 initial investigation, we are dealing with a different statutory question. We are dealing with
16 the question of whether or not an exception which enables a change, a divergence from the
17 reasoning in the 2009 report, should be applied in the particular circumstances.

18 When Mr. Green talked about the Competition Commission answering the statutory
19 question, it is important to bear that in mind. It is just not the investigation question, it is
20 the exception question under s.138(3). Occasionally he seemed to slip into language which
21 suggested that it was the 2009 report that was under challenge or the initial finding of an
22 AEC that was under challenge, when he talked about, for instance, section 3 of the report,
23 and the issues raised there. Certainly his heavy emphasis on *Tesco*, *Barclays* and *UniChem*,
24 which became a degree of mantra, where he was saying that we failed to engage with the
25 proper statutory question, again conflates the two things.

26 In each of those cases what one was concerned with was the primary market investigation
27 question. Certainly in *Tesco* and *Barclays* it was the primary market investigation; in
28 *UniChem* it was the primary merger control question, but it certainly was not this question
29 about whether or not, given a lapse of time, were there material changes of circumstances.
30 That sets the statutory background in these circumstances. Of course, the Competition
31 Commission, as is plain from the way that it approached the 2011 ----

32 THE CHAIRMAN: Just on the point that you have just made, where does that take us? Here the
33 Competition Commission decided that there was a material change of circumstance, namely
34 change in government policy. Having done that ----

1 MR. BEARD: Actually, what it did was it said there was a significant change of circumstance,
2 and reached those conclusions.

3 THE CHAIRMAN: Are you saying they did not say there was a material change of
4 circumstance?

5 MR. BEARD: It was cautious about the way that it dealt with it for the reason I have articulated
6 in relation to para.25. The Competition Commission's preferred way of looking at it was
7 that it constituted a material change of circumstance, but that it did not warrant any
8 departure from the remedies.

9 THE CHAIRMAN: Yes, but if the Competition Commission decides that a material change of
10 circumstances has arisen, do they not have to then look at the question of whether there is a
11 continuing AEC and what ought to be done in relation to it in pretty much the same way as
12 they were in the initial report?

13 MR. BEARD: No, that is the reason it may be material.

14 THE CHAIRMAN: Sorry, what may be material?

15 MR. BEARD: The distinction between the two statutory tests. Here there is not a specific test.

16 THE CHAIRMAN: I am so sorry, when you say "the two statutory tests", which do you mean?

17 MR. BEARD: The statutory requirements of carrying out an investigation and the statutory
18 requirements of considering s.138(3). It is of course true that it is precisely what the CC
19 did, go back and look at the way in which the remedy of the divestment of Stansted fitted
20 with the findings in the report. It is notable that there is not a specific challenge to the
21 finding of AEC that is being made here. The question does arise as to whether or not
22 s.138(3) specifically allows a challenge to the AEC, albeit we entirely accept the
23 consideration of remedies is going to involve consideration of the factors that would
24 otherwise go to an AEC. It may be that the distinction is less significant once you have a
25 finding that there is a material change of circumstance or a significant change of
26 circumstance and the proportionality assessment has to be undertaken. Nonetheless, the
27 Commission is concerned that it should not just be presumed that the whole of the report
28 gets unwound, because that is not what s.138(3) is focused upon.

29 THE CHAIRMAN: It may be that I have not followed things closely enough, but I did not
30 understand that BAA are challenging the existence of an AEC in relation to the continued
31 joint ownership of Heathrow and Stansted.

32 MR. BEARD: No, that is what we understand to be the position as well.

1 THE CHAIRMAN: In terms of analysing s.138(3), this does not seem to be presented as a
2 challenge where it is said, “The material change of circumstance means that there is not an
3 AEC”?

4 MR. BEARD: No, agreed.

5 THE CHAIRMAN: The focus seems to be on the remedy that is said to follow. Focusing on that
6 latter possibility, however, if there is a material change of circumstance is the obligation on
7 the Commission not then to look at matters afresh, in which case why is there not the same
8 duty of investigation, making sure that they understand the situation fully, in place there as
9 would be under an original investigation?

10 MR. BEARD: I can deal with it in relation to proportionality, but to start with, if you have not
11 got a challenge to the AEC, the question you are first asking yourself is, is a remedy
12 effective? Effective to what end? Plainly it is to remedying the AEC that was previously
13 found to exist. The provision of s.138(3) does mean that you are not starting afresh. The
14 question is, should you be departing from your previous findings in relation to remedies? If
15 there is a significant change of circumstance which was identified in this report, yes, it will
16 be for the CC to consider the sorts of material that are being given to it. There may be some
17 circumstances where things are such that it would carry out its own investigations, but it is
18 not a replication of some sort of two year market investigation in order to fulfil the s.138(3)
19 consideration process. That is the distinction the CC are concerned to draw, that it is not a
20 case where you can simply assume that precisely the same approach should be adopted in
21 relation to a s.138(3) assessment as is adopted in relation to market investigation. In
22 relation to market investigation you have to make the AEC finding.

23 THE CHAIRMAN: Sometimes, if there is a material change of circumstances it may be said that
24 that does affect the AEC finding. What happens then? Are you saying that then you do
25 have to do a fuller investigation?

26 MR. BEARD: There are two questions. One is whether or not the statutory scheme actually
27 enables that to happen. Of course, the statutory scheme dealing with s.138(3) is talking
28 only about remedial consequences and not the AEC at all. What s.138(3) is saying is, “Can
29 you depart from your report in terms of the remedies you can put in place?” It is not saying,
30 “Can you revisit the basic findings in the report that were made?”

31 THE CHAIRMAN: Surely, if there were a material change of circumstance that made it clear that
32 what used to be an AEC is no longer an AEC?

33 MR. BEARD: I entirely accept that. There must be ----

34 THE CHAIRMAN: I am not sure what point you are making.

1 MR. BEARD: The point I am making is simply making sure that we are dealing with the
2 statutory scheme properly because the Competition Commission is concerned to do that.
3 There has been almost no discussion of the finding of an AEC here. The Competition
4 Commission considers that that was significant and it continued to be significant and it is
5 not under challenge here.

6 What is significant then is what comes forward, whether or not the exception jurisdiction
7 should be exercised on a departure from that? It is recognised that there could be
8 circumstances where the change is so radical that effectively it undermines the finding of an
9 AEC. In those circumstances, it would plainly be good reason why you did not put in place
10 remedies even if, as a matter of legal formality, the AEC stayed in place. So, yes, we do see
11 that there may be circumstances where the same considerations come into play. What the
12 precise formal legal consequences are may be slightly more complicated to work out.

13 THE CHAIRMAN: Can I just check one thing with Mr. Green. Mr. Green, I have understood
14 your case correctly, have I not? I was not conscious that you had attacked the finding, and
15 continued reliance on the finding, in 2009 that there was an AEC arising from the joint
16 ownership, not just of Heathrow and Gatwick, but Heathrow, Gatwick and Stansted?

17 MR. GREEN: I am just checking our notice of application. Our notice of application makes two
18 points: first, that the change of circumstance goes to the existence of the AEC; and
19 secondly, to the remedy. This is para.3 of the notice of application.

20 THE CHAIRMAN: If you can give me your skeleton and speaking note references as well?

21 MR. GREEN: The speaking note simply assumes that those are two things we are making
22 submissions about.

23 THE CHAIRMAN: Where does it make that assumption? What is the best paragraph to see that
24 assumption? I do not remember you addressing me at all about that. It may be that my
25 memory is at fault.

26 MR. GREEN: Our submission in paras.6 and 7, the difference questions arising for determination
27 in 2011 ----

28 THE CHAIRMAN: This is the speaking note?

29 MR. GREEN: Paragraphs 6 and 7, identifying two different questions which we said arose as
30 between the two dates, and one of the reasons for drawing your attention so extensively to
31 chapters 3 and 5 was to show that ----

32 THE CHAIRMAN: I do not think you took us to those paragraphs, so let me just read those.
33 (After a pause) That sets out the two questions.

34 MR. GREEN: Paragraph 3 of our notice of application ----

1 THE CHAIRMAN: If you were challenging the finding of an AEC, where is that? That is not in
2 those paragraphs? That is just saying that the questions which arose for determination by
3 the CC ----

4 MR. GREEN: Were different, including different AECs.

5 THE CHAIRMAN: Where are the paragraphs in your speaking note where you say the first of
6 those questions is under challenge?

7 MR. GREEN: Our submission was, in a sense, that the same criticisms go to both questions. I do
8 not think it is explicitly set out. We simply rely on our notice of application.

9 THE CHAIRMAN: Which was the paragraph in the notice of application?

10 MR. GREEN: Paragraph 3, and it is very explicit – that is bundle A, tab 1, p.4. The last sentence
11 says:

12 “The CC accepted this was a MCC which required it to reconsider whether
13 common ownership of Heathrow and Stansted ...”

14 THE CHAIRMAN: That is what the CC did. Where is your challenge?

15 MR. GREEN: Then:

16 “BAA submits that these conclusions were flawed on four grounds.”

17 One of the reasons for taking you in particular to para.10.117 was ----

18 THE CHAIRMAN: 10.117.

19 MR. GREEN: I do not want to repeat this. This was that paragraph ----

20 THE CHAIRMAN: No, I have got to understand your case. You did not expand upon this, and
21 that is why ----

22 MR. GREEN: I am sorry, I thought it was implicit that everything I said that the two issues are
23 really intertwined.

24 THE CHAIRMAN: Paragraph 10.117.

25 MR. GREEN: Of the 2009 report.

26 THE CHAIRMAN: It is slightly disturbing that after two days of hearing from you, both
27 Mr. Beard and the Tribunal are left confused about what seems to be a very fundamental
28 point. 10.117?

29 MR. GREEN: You will recollect that that is the paragraph in which the CC say they have
30 sufficient confidence in the continuation of government policy that it would not invalidate
31 any of the divestiture at all. We drew attention to that because new capacity was
32 fundamental to the whole case. There is no finding ----

33 THE CHAIRMAN: 10.117, let me look at that.

1 MR. GREEN: There is no finding that absent capacity there would be an AEC in the 2009
2 decision. I did not think that was a matter in dispute, that the Commission had not found
3 that, absent capacity, there would be. My purpose in taking you so extensively to the report
4 was to show you the centrality of capacity.

5 THE CHAIRMAN: Paragraph 117 seems to be talking about the remedy.

6 MR. GREEN: It refers to the effect on the remedy, but more broadly, and really the submission I
7 made was that capacity was so central to the report that that was what justified it. I
8 repeatedly made the submission that there was no criticism of them for not making a finding
9 about non-capacity because it was not material.

10 THE CHAIRMAN: All right, you are saying that you are challenging the finding of the AEC?

11 MR. GREEN: We stand by our notice of application.

12 THE CHAIRMAN: Even though not developed in your speaking note. I just go back to paras.3
13 and 4 of the notice of application.

14 It is unsatisfactory, but Mr. Green, although he has not developed the point, says that he
15 does maintain that.

16 MR. BEARD: It is more than unsatisfactory. The reason I was going to the statutory provisions
17 is because Mr. Green did not go to these. Mr. Green did not develop the consideration of
18 AEC. In the defence we specifically talked about this statutory framework. It has never
19 been adequately dealt with. The reference to his notice of application is his description of
20 what he says the CC was engaged in in 2011. It is not accurate because the CC in 2011
21 talked in para.3 about what the duty was that it was exercising. It focused on remedies. As
22 the Tribunal has rightly indicated, 10.117 to which Mr. Green refers is to do with remedies.
23 It is not surprising, section 10 of the report is entirely to do with remedies. It comes after
24 sections 8 and 9, which are concerned findings or features that give rise to an AEC and the
25 need for remedies. I will take the Tribunal to those sections.

26 THE CHAIRMAN: Can I just check with Mr. Green. Mr. Green, I am rather taking it that there
27 is nothing in your skeleton argument that assists on this?

28 MR. GREEN: I assumed that all our submissions ----

29 THE CHAIRMAN: There is nothing in your skeleton argument?

30 MR. GREEN: Mr. Chamberlain has just reminded me, the skeleton repeats the notice of
31 application in those terms. Paragraphs 3 and 4 of the skeleton repeat the notice of
32 application.

33 THE CHAIRMAN: Thank you.

1 MR. BEARD: When we come on to the grounds we will see further evidence that actually there
2 is no challenge to the AEC. Nothing in the skeleton or the notice of application, which
3 actually goes through the grounds, refers to any challenge to the AEC whatsoever.

4 THE CHAIRMAN: The parts of the 2009 report which deal with the AECs arising from common
5 ownership are what?

6 MR. BEARD: They are actually sections 2 to 9. I will go through some of these, but it is the
7 main part of the report setting out the conclusion that there were features – the reason I went
8 to s.134(1) is because what the Commission has to do is identify whether there are features
9 of the referred market that give rise to an AEC. It does that in section 8 of the report. Then
10 in section 9 of the report it goes on to consider these matters. If it assists, it is perhaps
11 worth pulling out the report. I will go through some of these sections in a more detailed.

12 THE CHAIRMAN: We were given a reading list, which was not the full report, it was chapters 3,
13 5 and 10, which, at least in my case, was part of the reason why I had not understood that
14 there was a challenge to the finding of AECs, but Mr. Green says there is.

15 MR. BEARD: I confess that those were the suggestions of our reading in the light of what we
16 understood the challenge to be and the terms in which it was made.

17 THE CHAIRMAN: That I understand, but I do not think Mr. Green suggested any different
18 reading list.

19 MR. BEARD: Not as far as I am aware. Indeed, there has been no reference to either of these
20 sections, which is why ----

21 THE CHAIRMAN: It is very unsatisfactory, but you just help us on these findings.

22 MR. BEARD: It is relatively quick to look at section 8, which is at p.217 in my bundle. I am
23 slightly conscious that there might be slightly different page numbering. Section 8 is a
24 very brief section, because what it is doing is identifying clearly how the CC says that the
25 statutory test, which it is, of course, answering in this report, under s.134(1) has to be
26 answered – in other words, are there any features that give rise to AECs. 8.1 says what did
27 we consider:

28 “The features of the market we have considered may affect competition:

29 (a) between airports;

30 (b) between airlines; and

31 (c) in other markets, such as the supply of services at airports.”

32 Then 8.2 is a general point about how a market feature may have an AEC in more than one
33 market. 8.3 is about the interaction between these markets, which is understandable. Then
34 8.4:

1 “For the reasons given in the preceding sections of the report, we have found a
2 number of features which each (and, in certain circumstances, in combination)
3 prevent, restrict or distort, and thereby adversely affect competition between
4 airports and airlines.”

5 So that is the statutory test under s.134(1) being considered. What are they? As regards
6 common ownership, (i) is Edinburgh and Glasgow, so that Scottish airports’ common
7 ownership is such a feature, and then:

8 “(ii) Common ownership of the three BAA London airports is a feature of the
9 market which prevents competition between them (see paragraph 5.42(b)) ...”

10 which there has been reference to previously and we will come back to that.

11 “The intensity of that competition may initially be limited by current capacity
12 constraints and price controls, but these constraints are themselves at least in part
13 the result of common ownership.”

14 So that is what drops out of the prior analysis of sections 3, 5 and 7 in particular.

15 Then there is common ownership of Southampton at (iii). Then:

16 “(iv) Common ownership of the BAA London airports is also a feature of the
17 market that, inter alia, restricts or distorts competition between airports in relation
18 to capacity development.”

19 So that is a specific AEC finding.

20 “(v) Common ownership of the BAA London airports also exacerbates the
21 inadequacies of the regulatory system, reducing the benefits of regulation and
22 distorting competition between airlines.”

23 I will take the Tribunal to section 5 and 6.88 in due course.

24 Then (b) is about Aberdeen. One turns over the page to (c), Heathrow’s special position as
25 a hub airport is actually identified as a feature that has an adverse effect on competition. It
26 is not at issue in these proceedings, but it is just worth mentioning. Then (d):

27 “Aspects of the planning system are a feature which restricts and/or distorts
28 competition.”

29 So this is section 4, a section that really is not particularly germane to these proceedings.

30 Because the CC was looking at the market in relation to airport services in general and
31 BAA’s holding of them in particular, it looked at all the different dimensions that
32 constrained the way they operated.

33 Then (e):

1 “Aspects of government policy are features which restrict or distort competition
2 ...”

3 Then (f) regulatory system.

4 So those are the features discharging that test. Then one turns on to the need for remedies.
5 That is in section 9. Of course, having answered the s.134(1) question it had to answer the
6 s.134(4) questions and the 138(2) which are obviously interlinked, the duty to remedy any
7 adverse effects that it has identified by reason of the features in the market.

8 Then at 9.1 one can see:

9 “BAA’s ownership of the four South-East airports [that includes Southampton for
10 these purposes] prevents any competition between them.”

11 Then there is the sentence about Glasgow.

12 “The competitive constraints imposed on those airports by other airport operators
13 have been limited at best. In the London area there is an almost complete absence
14 of competition and almost total market failure. Even though there is some
15 passenger substitutability between Stansted and Luton, it is less than between
16 Stansted and the other BAA London airports. BAA’s common ownership of
17 Southampton with Heathrow and Gatwick also has an impact on Southampton.
18 While Glasgow is subject to some pressure Prestwick ... There are no close
19 substitutes for Aberdeen ... Airlines and passengers at BAA’s airports have either
20 been entirely deprived, or substantially deprived, of the innovation, enterprise and
21 concern for their interests that competition brings. These shortcomings, which are
22 extensive, have been felt by airlines and passengers alike in prices and/or quality of
23 service.

24 9.2 The consequences of common ownership are far reaching. In the South-
25 East in particular there is no competitive market for airport services that allows us
26 to predict how competition will develop. The scope for competition between
27 airports and the ways in which competition can develop are illustrated by evidence
28 from our case studies of competition between airports in other parts of the UK.”

29 THE CHAIRMAN: Yes, and as I understand it, and certainly Mr. Green did not take us to these
30 paragraphs or indicate what his challenge was, but he tells us there is now a challenge. It is
31 very unsatisfactory but you can just show us the paragraphs and we will deal with it.

32 MR. BEARD: I was going to come back to this, but since we are there, if the Tribunal will
33 indulge me ----

1 THE CHAIRMAN: I think it is important because we learn that there is an important submission
2 being made.

3 MR. GREEN: I wonder if I can help matters, I have just been going ----

4 THE CHAIRMAN: I think Mr. Beard is helping us, thank you.

5 MR. GREEN: I was going to make a concession, if it helps.

6 THE CHAIRMAN: A concession?

7 MR. GREEN: Yes.

8 THE CHAIRMAN: That would help.

9 MR. GREEN: Just to clarify something. I have just been going through the notice of application
10 and just trying to be clear as to what we did say and what we did not say. I think it would
11 be fair for us to accept that, as we pleaded it in the notice of application, notwithstanding
12 the way we put it in 3 and 4, the question of AEC is only addressed semantically in relation
13 to ground two. I think probably, in those circumstances, it is better that I simply stick to
14 that and leave grounds one, three and four as nothing other than remedy. I think that will
15 short-circuit Mr. Beard's concerns.

16 THE CHAIRMAN: Just remind me, ground two is what?

17 MR. GREEN: That is the extra spare capacity point. As a matter of drafting of the notice of
18 application, that has been explicitly addressed under the heading of an AEC. The others, I
19 accept, are more ambiguous. The others essentially refer to remedy. That would mean that
20 the ----

21 THE CHAIRMAN: Even on that, would you not have had to attacked, for instance, paras.9.1 and
22 9.2 of the 2009 report, which I did not understand you to have done. You certainly did not
23 ask us to read them.

24 MR. GREEN: I think it is common ground there was no finding in the decision that, absent
25 capacity, the common ownership of Stansted and Heathrow alone is an AEC. That is just
26 factually correct. The way in which the AEC is categorised in para.8.4 is common
27 ownership of ----

28 THE CHAIRMAN: Paragraph 8.4 – is that of the 2009 report?

29 MR. GREEN: Yes.

30 THE CHAIRMAN: Mr. Beard, I think we need some clarity. Let us sort this out with Mr. Green
31 first.

32 MR. BEARD: Certainly.

33 THE CHAIRMAN: Tell us where in your notice of application this is dealt with, and then in your
34 skeleton and your speaking note?

1 MR. GREEN: We are not going to make a point in relation to one, three and four, and that clears
2 the air and clears the ground for Mr. Beard in relation to that.

3 THE CHAIRMAN: Even though you helpfully pointed out that it seems from your notice of
4 application and skeleton that, although it was rather buried, you did seem to be taking ----

5 MR. GREEN: I think the way in which – I have to confess that we have rather assumed that our
6 submissions on one will necessarily concern the other, but it does not, I do not think, make a
7 great deal of difference to our submissions. I think it is just easier if we clarify and make
8 that concession.

9 THE CHAIRMAN: So grounds one, three and four ----

10 MR. GREEN: Go to remedy only.

11 THE CHAIRMAN: Remedy only, no challenge to any finding of AECs.

12 MR. GREEN: And that means the question is, was the adoption of a remedy, or which remedy,
13 appropriate.

14 THE CHAIRMAN: No challenge to AECs in 2009 report by reason of the identified MCC
15 arising from change in government policy – is that right?

16 MR. GREEN: That is correct, yes.

17 THE CHAIRMAN: Ground two, show us what you say about that?

18 MR. GREEN: If you look at para.4(2) of the notice of application, and indeed it is repeated in the
19 skeleton ----

20 THE CHAIRMAN: Ground two, para.4(2).

21 MR. GREEN: That is explicitly stated to be:
22 “The CC’s assessment of the question whether, notwithstanding the MCC since the
23 2009 Report, common ownership of Heathrow and Stansted gave rise to an AEC,
24 and of the timing and sequencing of the divestiture remedy ...”
25 Then there are four grounds referred to.

26 THE CHAIRMAN: I see that. In your skeleton that is which paragraph?

27 MR. GREEN: It is the introductory paragraphs, para.4.

28 THE CHAIRMAN: Is there anything else in your notice of application in relation to this?

29 MR. GREEN: There is the elaboration of the ground.

30 THE CHAIRMAN: What is being pointed out to me is that in the detail of your pleading,
31 para.72, you actually say “diminishing the extent of the AEC”, not eliminating it.

32 MR. GREEN: The submission is that it diminishes to such an extent that it actually is not to be
33 counted as an AEC.

34 THE CHAIRMAN: Where are the words that say that?

1 MR. GREEN: That is effectively what we are saying. That is under the heading to ground two,
2 which is “Flawed assessment of whether common ownership gave rise to an AEC”. The
3 conclusion at para.90 is:

4 “The CC’s assessment of developments since the 2009 Report and the implications
5 for the scope for competition to arise from the divestiture of Stansted was vitiated
6 by failures to investigate the causes of the decline in traffic, the quality and
7 longevity of the resulting increase in spare capacity at Stansted and by an irrational
8 assessment of the implications of that increase in spare capacity.”

9 THE CHAIRMAN: Yes, para.74:

10 “... accordingly the AEC addressed by the divestiture remedy was less significant
11 ...”

12 You do not say “did not exist”.

13 Anyway, we are exploring your concessions at the moment. We see these references. You
14 say that a case is made out to challenge the AECs. The references in your skeleton
15 argument are where? Since I have been so confused up to now, I want to make sure I have
16 got a full documentary trail through your three documents so that I know what you are
17 saying. Mr. Green, perhaps while Mr. Chamberlain is looking for that, can you give us the
18 references in your speaking note because that is going to be my next question.

19 MR. GREEN: In the skeleton, ground two, additional spare capacity, is dealt with from 118 to
20 124. The significance is at 124.

21 THE CHAIRMAN: Sorry, just give me those references again?

22 MR. GREEN: Skeleton 118 to 124, and the speaking note is just 252 to ----

23 THE CHAIRMAN: I am sorry, just looking at those, where is the bit where there is the challenge
24 to the finding of AEC? I am just scanning it even for the initials AEC, and I am not seeing
25 it.

26 MR. GREEN: The words are not in the skeleton.

27 THE CHAIRMAN: Which is the paragraph which explains the challenge?

28 MR. GREEN: It is effectively under the heading at 124.

29 THE CHAIRMAN: Let me read 124. (After a pause) I do not read in 124 a challenge to the
30 finding of AEC. Did you want to highlight some particular words there?

31 MR. GREEN: I think the only sentence I would refer you to in that regard is the sentence in the
32 middle starting:

33 “A proper analysis of the quality of the extra spare capacity might well have
34 revealed that the economic significance of this capacity was *de minimis*.”

1 That is the nearest those paragraphs come to in making the point.

2 THE CHAIRMAN: All right, speaking note?

3 MR. GREEN: Speaking note, 252 to 263.

4 THE CHAIRMAN: Are those just the paragraphs that deal with ground two?

5 MR. GREEN: Yes.

6 THE CHAIRMAN: So which is the paragraph that deals with the challenge to the AEC?

7 MR. GREEN: The conclusions are at 263. It is just a general conclusion that there is a failure to

8 take account of a material consideration. That is sub-para.(1). Sub-para.(2) is as to whether

9 it should order divestiture of Stansted, so that is a “whether” in relation to remedy. Then

10 (3), “in any event, failed to examine the causes of this spare capacity...[and] may well have

11 been *de minimis*”.

12 THE CHAIRMAN: What is being pointed out to me in your speaking note is para.253:

13 “... BAA complains that the CC did in fact take spare capacity into account in its

14 reasoning on proportionality ...”

15 You claimed that it had not, and it did so without conducting any analysis. That seems to

16 go to the proportionality of the remedy.

17 MR. GREEN: In our submission, it goes to both. It certainly goes to remedy.

18 THE CHAIRMAN: I am just trying to see where you spell out the argument. Ground two, you

19 say, raises a short but significant point, which you then explain in para.253 in terms of

20 proportionality, not an attack on AEC.

21 MR. GREEN: I simply say that is where they have taken into account the error. You will

22 recollect that there is a difference between a number of paragraphs. There are two

23 paragraphs, 114 and 285, where we submit they have taken it into account when they have

24 said it was relevant.

25 THE CHAIRMAN: Then, since I do not think you showed us the paragraphs in the 2009 report –

26 you had better just list them for us – which you say contained the finding of AEC which you

27 are now indicating you challenge. Which paragraphs are they?

28 MR. GREEN: Chapter 9 of 2009.

29 THE CHAIRMAN: 2009 is where the findings of AEC were made, and you say those are under

30 challenge.

31 MR. GREEN: The findings of the features which give rise to the AEC are in chapter 8.

32 THE CHAIRMAN: Chapter 8 deals with a range of matters. What I was hoping for was a list of

33 the paragraphs dealing with this particular AEC, or do you say it goes to all the AECs?

1 What is so unsatisfactory, Mr. Green, is that you have not explained clearly to us, on my
2 understanding, that this is an aspect of your challenge. So far as I am aware you have not
3 identified for us the paragraphs in the 2009 report where the AEC finding was made and
4 then explained what challenges you make to that. Do you not have to do that to explain to
5 us the challenge?

6 MR. GREEN: Paragraph 8.4(a)(ii) of the 2009 report is the features which affect competition and
7 which give rise to the AEC in relation to the London airports.

8 THE CHAIRMAN: Sorry, can you give me the reference again?

9 MR. GREEN: Yes, 8.4(a)(ii) p.217 of the 2009 report.

10 THE CHAIRMAN: 8.4(a) ----

11 MR. GREEN: This is under the heading "Finding of features", and this is, as it were, the
12 conclusionary section on what is an AEC.

13 THE CHAIRMAN: Yes, that is one of the paragraphs I think Mr. Beard just showed us, you did
14 not show us that, but you are now saying that is the paragraph you challenge?

15 MR. GREEN: That is why at the beginning of the speaking note we identified the difference
16 between the issue in 2011, which was essentially this: the AEC there was identified as three
17 airports in the context of new capacity, and we say it is different in 2011 because it is one
18 airport without capacity.

19 THE CHAIRMAN: Is that the only paragraph where they deal with common ownership of the
20 airports? It does not seem to be because there seems to be a cross-reference. If you can
21 supply us with all the other paragraphs that you say include the relevant finding of AEC
22 which should have been challenged.

23 MR. GREEN: 5.42(b) was a paragraph I took you to and made submissions about, p.127, which
24 is the paragraph cross-referred to.

25 THE CHAIRMAN: Are those the only two paragraphs that deal with them?

26 MR. GREEN: That is where they identify the AEC, which is, of course, just a final conclusion as
27 to the previous analysis. I drew the Tribunal's attention to that in the context of a
28 submission that this was capacity dependent.

29 THE CHAIRMAN: I thought you drew our attention to that in the context of ground one, not
30 ground two. In fact, I am fairly sure you did.

31 MR. GREEN: It was certainly during my submissions on ground one. Our overall submission,
32 which is now ----

33 THE CHAIRMAN: All right, any other paragraphs that might be helpful for us to read to assess
34 this challenge that you have just explained?

1 MR. GREEN: No.

2 THE CHAIRMAN: Yes, thank you. Mr. Beard?

3 MR. BEARD: I am grateful. Just since we were in section 9 – I was going to come back to it
4 later in submissions, but since we have started it perhaps now is the time to keep going
5 through it. It is just a matter of continuity.

6 I should say, just to anticipate, the reason I am taking the Tribunal through this is because in
7 order to get the context of what was going on in this report, and how it was understood,
8 whether or not it was just new runway capacity that was the predicate, it is important to
9 actually understand what the report as a whole was doing. These are submissions that in
10 due course will go to ground one, but in anticipation, since we are here now ----

11 THE CHAIRMAN: Can I just ask, do you accept that the only relevant paragraphs with an AEC
12 of common ownership are 8.4(a)(ii) and 5.42?

13 MR. BEARD: No, those are the conclusory paragraphs.

14 THE CHAIRMAN: I rather thought there was more than that.

15 MR. BEARD: The difficulty is that the analysis leads up to that, and therefore talks about how
16 competition works and why the particular features have this adverse effect. It is the case in
17 relation to all of them in the preceding chapters and in the accompanying annexes.

18 THE CHAIRMAN: Not necessarily now, but it would be helpful if you could supply us just with
19 a note of the paragraph references in due course so that we can understand Mr. Green's
20 submissions.

21 MR. BEARD: Certainly. There is one particular point which it may just be worth highlighting
22 now. Mr. Green, when he was taking you through various bits and pieces in section 10,
23 which is obviously the remedial bit, did not take you to 10.46. 10.46 is a paragraph that
24 effectively unpacks that AEC finding dealing with the issue of whether or not Stansted
25 should be divested as well as Gatwick. 10.46 actually says:

26 "In the following paragraphs we set out our reasons for believing that BAA's
27 ownership of Heathrow and Stansted is a feature that has an AEC, even in
28 circumstances in which Gatwick has been divested. It is our view that the evidence
29 does not support BAA's position on substitutability, nor do we accept BAA's view
30 that excess demand at Heathrow would preclude continuing common ownership
31 from giving rise to anti-competitive distortions in behaviour."

32 I will come back to that in due course, because obviously that was one of the criticisms that
33 was levelled.

34 THE CHAIRMAN: You say Mr. Green did not take us to that. I have got it marked.

1 MR. BEARD: I do not think he went to 10.46. I think he went to 10.48 onwards. If I am doing
2 him an injustice, I am sorry. The point is still there, whether or not he took us there. As I
3 say, that is not, by any means the full story. The full story drops out of the preceding
4 analysis.

5 THE CHAIRMAN: (The Tribunal conferred) Yes, please go on.

6 MR. BEARD: I was just going to go back to section 9. So, complete absence of competition in
7 the London area, almost total market failure, 9.1. Common ownership, the consequences
8 are far reaching, 9.2. 9.3, plentiful evidence of monopolistic behaviour:

9 “The consequences of common ownership and absence of competition are most
10 obvious in aspects of BAA’s performance – its lack of engagement with its airline
11 customers, insufficient strategic management of the airports, inefficient investment
12 by BAA at airports in the South-East in particular, and an unsatisfactory passenger
13 experience at many BAA airports. Inefficient investment has not only had
14 detrimental effects on customers in the past but can hamper the development of
15 competition in the future.”

16 The reason I highlight these points is, as you can perhaps anticipate, in relation to ground
17 one, the points that are being drawn out in the conclusions, this is not about new runway
18 capacity, this is about past evidence that has been drawn upon about the concerns about
19 BAA’s conduct and performance.

20 9.4, less criticism of Glasgow and Edinburgh.

21 “9.5 The markets in which BAA’s airports carry on business are highly
22 significant ...”

23 It is not just a problem, it is a big problem, because the London airports are really important,
24 not just in terms of transportation, but for the broader economy.

25 9.6 is interesting: the Commission, when it is carrying out this analysis actually looks at
26 how airports have developed and then compares it against the way in which the airline
27 industry has developed and talks about the changes over the past 15 or 20 years. It is almost
28 a matter of judicial notice that Ryanair and EasyJet 20 years ago were not significant.
29 EasyJet did not even exist. The whole structure of the way that air transport has developed
30 has changed radically. The point that is being is that in comparison airports have not.

31 Then 9.7:

32 “In considering whether remedies are necessary and the form that such remedies
33 might take, we have to consider the remedies for AECs and, or alternatively, their
34 detrimental effects on customers. The Enterprise Act does not require us to

1 remedy market features. In many cases remedying the AEC will mean addressing
2 relevant market feature ...”

3 Then 9.8:

4 “Severing the common ownership of airports that can and should compete will
5 immediately enable new owners to compete with each other and with BAA in a
6 number of different ways.”

7 Then it talks about competition on price, quality of service, competition to attract new
8 services in Scotland. Then 9.9:

9 “In the South-East, the benefits of competition would be felt almost immediately in
10 service quality, but also, and to a more modest extent, on price. As competition
11 between airports develops, greater benefits will accrue.

12 9.10 We have shown that lack of competition between airports can have
13 significant adverse consequences for the quantity, quality, location and timing of
14 investment, investment currently being determined according to the priorities
15 resulting from monopolisation rather than competition.”

16 Then 9.11 is instructive: “This is particularly the case in relation to runway capacity.” So
17 9.10 is a generalised conclusion about the problems of monopolisation and incentives and
18 the impact it has on investment. 9.11 is saying that is particularly the case in relation to
19 runways.

20 “We recognise BAA was privatised as a whole for good reason, in particular, to
21 ensure capacity development in the south east as demand grows. While airport
22 capacity has increased over the last 20 years, there have been no new runways,
23 and there is now a shortage of runway capacity at Heathrow, and to a lesser extent,
24 at Gatwick. We have found that common ownership of BAA’s airports can no
25 longer be considered an engine of capacity development. Rather, it has become a
26 brake on it.”

27 MR. ALLAN: Are there any points in the more detailed discussion in the report that you can give
28 to us where the Commission discussed failures of investment in relation to commence the
29 other runway capacity?

30 MR. BEARD: Yes, in section 7. I was going to come on to that when I dealt with the capex
31 criticism on proportionality. Unless there is anything in particular, I will move on to that
32 later. Section 7 of the report is about BAA’s performance. It deals with capital
33 expenditure, it deals with service quality and it talks about the SQRs and how they have
34 worked or not worked, it talks about efficiency issues, it talks about access to financial

1 markets. There is a detailed assessment of relevant evidence here that is taken into account.

2 I was going to take you to each of those in due course.

3 MR. ALLAN: That is fine.

4 MR. BEARD: Now 9.12:

5 “It is not merely the case that BAA has been slow to advocate or pursue runway
6 development. BAA’s common ownership of Heathrow, Gatwick and Stansted
7 means that in so far as it has been prepared to lobby the government in relation to
8 the appropriate location and timing of development and in so far as that lobbying
9 affects government policy, the subsequent development will reflect BAA’s
10 monopolistic priorities. Under separate ownership, the operator of Gatwick
11 would, for example, have a strong incentive to see government support a second
12 runway in order to compete with Heathrow and Stansted.”

13 To anticipate what Mr. Green will say: this is all about Gatwick, of course Gatwick did not
14 have any new runway capacity suggested for it at any time arising at that point. What is
15 being said is if you have got a separate owner for Gatwick, even though you have not lined
16 up an additional runway, you are going to have a massive incentive to start lobbying for
17 that. So it is a different point. Indeed, the very fact that Gatwick does not have any
18 prospective new runway capacity in some ways gives a further lie to the interpretation that
19 BAA is putting on this whole report, because there is something slightly weird about the
20 idea that Gatwick would be engaged in some competitive exercise when there is no prospect
21 of new runway capacity being contemplated in this report in relation to Gatwick. I make
22 that merely as a passing remark.

23 “9.13. The simple reversal of a feature such as common ownership is not enough
24 to undo at once the adverse effects that common ownership has had where those
25 adverse effects are inefficient investment in airport infrastructure. Even where
26 airports are owned by competitors, their development is capital intensive, merits
27 intense and sometimes lengthy scrutiny by the planning system, and may be
28 influenced by government policy. In relation to the London airports, we would
29 expect competition to deliver quality and modest pricing benefits straight away,
30 even when capacity constraints and price control regulation persist.; it would also
31 enable the regulator to undertake comparative competition and in doing so
32 improve regulatory settlements and best practice. But we would also expect
33 competition and pressures of rivalry soon to affect decisions about the form and
34 amount of significant additional capacity resulting in more efficient investment in

1 response to customers' needs, improved levels of service and lower prices. Over
2 time, the scale of the benefits would grow, driven by the momentum of developing
3 competition with the full benefits resulting from anticipated improvements in the
4 design costs, timing, allocation of new capacity, largely open to customers when
5 new capacity comes into operation, and the prospect that price control at Gatwick
6 and Stansted is withdrawn as competition develops.”

7 Undoubtedly, those latter parts do have in mind the new runways that were contemplated
8 for Heathrow and Stansted. Then 9.14 to 9.18 are talking about other aspects of BAA that
9 have been identified in Chapter 8. So the finding, the process that was gone through by the
10 Competition Commission was to look at the industry as a whole, look at all the dynamics of
11 that industry. It identified the fact that the BAA airports around London were competitors
12 of one another, it recognised that there was a range of dynamics of competition. Those
13 dynamics of competition were not just limited to competing in anticipation of or in relation
14 to new runway capacity. That was the foundation of the finding of the AEC and that is how
15 the 2009 report should be understood.

16 I am sorry to have diverted to that. I would like to go back to some further legal
17 submissions before I return to ground one, if I may.

18 I just briefly want to deal with the proportionality test, because there was a degree of flexion
19 in the way that BAA presented how proportionality assessments should be carried out, and
20 the relevant *Tesco/Fedesa* tests. I hope to be able to deal with this relatively quickly. The
21 easiest way of dealing with it in fact may be just to turn up para.265 of the 2011 Decision at
22 tab 2 bundle A. This paragraph simply sets out the proper approach to the assessment of
23 proportionality that is to be carried out. There is no dispute about these four tests being the
24 correct tests. They are the ones that have been articulated at European level in the *Fedesa*
25 case, and articulated in the *Tesco* judgment to which Mr. Green referred the Tribunal.

26 Indeed, that is at footnote 120. We have: (a) must be effective to achieve the legitimate
27 aim in question; (b) no more onerous than is required to achieve that aim; (c) must be the
28 least onerous if there is a choice of equally effective measures; (d) in any event must not
29 produce adverse effects which are disproportionate to the aim pursued.

30 In relation to (a), although on Monday Mr. Green talked about how you should consider
31 effectiveness by taking into account benefits and so on, yesterday he moved his position
32 back to a more orthodox one of saying: actually, you ask yourself whether or not the
33 remedy is effective to deal with the problem, no matter what the costs and benefits of it are.
34 That is the correct approach here.

1 The other point to pick up in relation to Mr. Green's submission was that initially he talked
2 about the aim in question being achieving the benefits of divestment, which was a
3 somewhat odd phraseology. Of course, that is not the case here. The question here is
4 whether or not the remedy is effective in dealing with the legitimate aim of resolving the
5 AEC. That is the question at (a).

6 You can see that in the Commission's 2011 decision at para.267 onwards (to which Mr.
7 Green took you yesterday) there is a consideration of that, and at 269:

8 "The requirement to divest Stansted offers a clear, easily implemented and timely
9 way of addressing the AEC of common ownership of Stansted and Heathrow
10 airports."

11 So that is the legitimate aim: divestment plainly effective, so (a) is met.

12 Then the requirements of (b) and (c) that --

13 THE CHAIRMAN: Can I just ask you on proportionality, if that had implications for the
14 evidential standard that is required to be satisfied - and sometimes, when one is looking at
15 European cases the evidential standard seems to be higher than a pure rationality test (I
16 confess when I say that what I have actually in mind are human rights which are relevant
17 because of Article 1 of Protocol 1).

18 MR. BEARD: I am not sure that it makes any material difference.

19 THE CHAIRMAN: There has to be a rational reading of the evidence.

20 MR. BEARD: Yes. I do not know whether there is any suggestion that this case turns on any UK
21 case law or ECHR case law, but the heads of judicial review that exist are incapable of
22 ensuring that there is proper scrutiny of relevant decisions that affect people's interests in
23 possessions and property, for instance, under Art. 1 Protocol 1, or indeed when you are
24 talking about EU provisions, that fundamental principles of EU law (which would also
25 include ECHR principles) would be met. So it is not clear that there should be any real
26 difference here. It is entirely recognised that this is a significant step; it has a significant
27 impact on BAA's business. That is why this lengthy report and reconsideration has been
28 gone through. But in terms of how one assesses in terms of the burden of proof or the
29 standard of proof, it is rather difficult to say.

30 THE CHAIRMAN: There are Strasbourg cases. The one I have at the back of my mind is the
31 case of *Vogt* from Germany which contains a formulation of the degree of evidence that is
32 required to make some interference (I think it was under Art.8 in that case) proportionate,
33 where there is being applied something higher than a pure rationality standard. Mr. Green
34 does not seem to have made a submission on that.

1 MR. BEARD: No, there is a passing reference to Article 1 Protocol 1 in his skeleton argument,
2 but no big play made of it.

3 THE CHAIRMAN: Article 1 Protocol 1 would plainly be relevant, would it not?

4 MR. BEARD: Yes, sorry. With “no big play” I was being slightly loose in my language. All I
5 meant was there was no suggestion that this radically changes the way in which one should
6 approach this. Indeed, with respect, the question that you are raising, Sir, must arise in
7 relation to aspect (b) of proportionality because aspect (b) is that it does not produce
8 adverse effects which are disproportionate to the aim pursued. It is not clear why any of
9 that would matter in relation to the question of effectiveness.

10 THE CHAIRMAN: All right. At all events, issue does not seem to have been joined on that.

11 You say it is just when one is addressing these four tests it is a rationality standard in terms
12 of assessment of the evidence.

13 MR. BEARD: It is a rationality standard in relation to the exercise to be undertaken. The
14 assessment of proportionality is a slightly different exercise. It is not merely a question of
15 rationality but when you come to scrutinise whether or not the Competition Commission’s
16 approach to proportionality was appropriate, you can of course bring to bear a reasonable
17 degree of scrutiny in relation to those matters. You are, after all, a specialist tribunal. But
18 (a) you have to recognise that the Competition Commission is a specialist body carrying out
19 a detailed assessment; (b) that does not mean that the burden for it to carry out further
20 investigations is suddenly changed; and (c) in any event the way in which the Competition
21 Commission goes about these sorts of matters plainly fulfils any of the higher standards that
22 you could possibly be talking about here.

23 THE CHAIRMAN: Right, thank you.

24 MR. BEARD: Just to go back to the second and third limbs of the proportionality exercise. First
25 is effectiveness. Then it is: must be no more onerous than is required to achieve that aim,
26 and if there are equally effective measures, must be the least onerous. Those matters are
27 considered just above para.271 of the 2011 decision, and then 274.

28 What is being said here is there is not another effective remedy. BAA came forward with
29 all sorts of suggestions about management separation and so on but what was being found
30 by the Commission here (and what was found back in 2009) was that unless you severed
31 common ownership you do not get the benefits that you would wish to accrue, because the
32 remedy is not effective in ending that adverse effect on competition that arises from
33 common ownership of airports.

1 Mr. Green took you through these paragraphs. They talk about divestment and whether or
2 not the arrangements in question that had been put in place are reasonable. I leave the
3 Tribunal to look at those.

4 THE CHAIRMAN: I am not sure if he did take us through these ones.

5 MR. BEARD: I have in my notes that he at least referred the Tribunal to these provisions. I am
6 not sure a great deal turns on it. The point I am making is merely that the Competition
7 Commission conscientiously looked at the proper approach to proportionality, and it worked
8 its way through. The point that I wanted to draw attention to was that this question of
9 effectiveness and the legitimate aim is all concerned with the AEC and these latter stages
10 are then considering whether or not there are equally effective measures and whether or not
11 this is the least onerous. In circumstances where this is the only effective remedy, those
12 condition are fulfilled relatively simply. But they do condition the way in which the
13 divestment arrangements are structured. For instance, BAA was never required to divest a
14 Scottish airport and the two London airports (or Stansted once Gatwick had gone)
15 simultaneously because that was seen as unduly onerous on BAA. So the considerations
16 did come into play in certain aspects of the remedial solution but not directly related to what
17 we are dealing with in these proceedings.

18 But then we get to the fourth point, which is in any event the solution must not produce
19 adverse effects which are disproportionate to the aim pursued. That is dealt with at
20 paras.280 through to 287. Of course, it cross refers to Appendix A. You have been taken to
21 a number of those sections and I will not repeat them.

22 THE CHAIRMAN: Yes.

23 MR. BEARD: But the point I wanted to make, as I say, was that the proportionality exercise in
24 legal terms was properly considered and actually the Competition Commission was getting
25 it right in the objectives and structure in relation to those matters. I will come back to deal
26 with how the proportionality exercise was carried out, dealing with ground one in particular.
27 Just three further brief points on law. One I have already touched upon: the nature of
28 inquiries to be undertaken. Mr. Green placed lots of emphasis on *Tesco* and *Barclays* and
29 *UniChem*, and he threw in a bit of *Tameside* for good measure about how one is supposed to
30 approach these matters. But none of that actually takes Mr. Green much further. Indeed, if
31 the Tribunal has authorities bundle 2 tab 27 (which is the *Barclays* case) - this was a case
32 about another market investigation into PPI. In terms of the consequences of it, it makes the
33 divestment of Stansted, which Mr. Green referred to as the largest intervention since the
34 Reformation, pale.

1 THE CHAIRMAN: I think we can take it that that was advocate's licence! Having said that,
2 clearly an order to divest Stansted is a very significant intervention for the Competition
3 Commission, so I am not sure that we needed the advocate's licence in order to make the
4 point that this was a very major remedy.

5 MR. BEARD: There is no doubt about it. The Competition Commission does not in any way
6 resale. It is a significant intervention and it does have a significant impact on BAA's
7 business.

8 THE CHAIRMAN: Yes.

9 MR. BEARD: No doubt. He referred to para.27. I am not sure if we actually went to it. Would
10 the Tribunal just read paras.26 and 27. (Pause)

11 THE CHAIRMAN: Yes.

12 MR. BEARD: In canvassing a number of the relevant decisions I am stressing that it is ordinary
13 judicial review principles that arise. Yes, there has to be care by the Competition
14 Commission in carrying out a market investigation where the consequences may be
15 significant. Of course there it was the principal market investigation under challenge. But
16 here, where we are considering material change of circumstance, the Competition
17 Commission obviously has to take care in considering all the representations made to it in
18 relation to those matters and matters following on. But the key thing is it is judicial review
19 principles that apply.

20 May I take you to authorities bundle 1 tab 20. This is a Court of Appeal decision, Laws LJ
21 giving the leading judgment in *Khatun v. Newham London Borough Council* - very different
22 situation concerning right to local authority accommodation. The paragraphs I wanted to
23 take the Tribunal to are 34 and 35. I just ask the Tribunal to read those. (Pause)

24 THE CHAIRMAN: Yes. I have read that. This is not a Human Rights case, is it?

25 MR. BEARD: I do not think it is couched as such, no. In a sense, the question mark that I have
26 in my mind is whether the fact that the Competition Commission is performing a
27 proportionality exercise, has to act in a proportionate way because Article 1 of Protocol 1
28 affects this in any way and if so, how.

29 THE CHAIRMAN: You say not.

30 MR. BEARD: We do not have any good reason to consider that it does. We set out the *Khatun*
31 decision and relied upon it in our defence.

32 THE CHAIRMAN: All right, so it may just be the case that Mr. Green has not sought to suggest
33 that there is a different approach.

1 MR. BEARD: Then one would have to hear. In fact, it is not going to make any difference in this
2 case because plainly what the Competition Commission did was ...

3 THE CHAIRMAN: As I understand it, your submission in fact is *Khatun* remains the relevant
4 standard, even when one is dealing with the proportionality review, at least in the
5 circumstances of this sort of case.

6 MR. BEARD: Yes.

7 THE CHAIRMAN: If you are wrong about that, Mr. Green seeks to argue that there is some
8 different, more intense standard, you say you meet that as well?

9 MR. BEARD: Yes. The point that is being made is that here we have got a situation where there
10 is relevant case law about how it is that a court dealing with matters on judicial review
11 principles should look at these issues.

12 THE CHAIRMAN: Sorry to pick you up on this, but you have to be a little bit careful about
13 talking about judicial review principles. Section 6(1) Human Rights Act imposes public
14 law duties to act compatibly with Convention Rights, so on judicial review if
15 proportionality requires more intensive standard that is the appropriate standard on judicial
16 review.

17 MR. BEARD: Of course. It feels slightly odd always talking about judicial review standards as if
18 they are some sort of selection of terse words and sentiments that could be articulated on a
19 couple of pages. Judicial review standards, as anyone dealing with the Administrative
20 Court well knows, are flexible and they can accommodate a whole range of circumstances.
21 So the Competition Commission is not suggesting anything otherwise.

22 I suppose there is one point to pick up, given Mr. Green's submission, which is he placed an
23 awful lot of emphasis on double proportionality, which was a phrase used in *Tesco*.

24 THE CHAIRMAN: Yes, I found it a curious phrase, although I think I understood what was
25 being got at.

26 MR. BEARD: I am not sure we entirely do. But if double proportionality means if something is
27 going to be important and can have important consequences, you have to think about it
28 carefully, which entirely fits with the scheme of judicial review standards, including human
29 rights standards then there is no issue. If it is saying that it means that courts should go
30 around saying what regulators should do in terms of investigations, then we would cavil at
31 such an interpretation.

32 THE CHAIRMAN: Can you just remind me of the paragraphs in *Tesco*?

33 MR. BEARD: Yes. 139.

34 THE CHAIRMAN: I was not suggesting we turn it up unless you want to.

1 MR. BEARD: It was just a passing comment in the light of the issue you were raising, Sir.
2 The second point I wanted to raise is about the meaning of the Report. Could the Tribunal
3 go to authorities bundle 1 tab 9. That is *MMC ex parte National House Building Council*.
4 This was a judicial review brought in relation to the regime that existed prior to the
5 Enterprise Act that enabled reports on monopolies to be carried out by the then MMC,
6 which is obviously the predecessor of the Competition Commission itself. The only point I
7 wanted to emphasise was just at para.23. None of the rest of it is germane to these
8 proceedings.

9 THE CHAIRMAN: Shall we read that?

10 MR. BEARD: Please. (Pause)

11 THE CHAIRMAN: Yes.

12 MR. BEARD: It is a sentiment that has been repeatedly endorsed, but it was one that had a
13 particular resonance yesterday as the discussion was going on about the meaning of the term
14 “accordingly” in the CAA summary and whether or not it had a different meaning from the
15 meaning of “accordingly” in para.5.8 in relation to a report that was referred to in an
16 appendix that was then relied upon and referred to subsequently.

17 THE CHAIRMAN: Yes. I do not think we need to get into argument whether the same approach
18 applies to a CAA report. Perhaps it does, but that is not what is under review. In relation to
19 that report, although the point has been pleaded with permission, we were not going to
20 trouble you with that, because we were unpersuaded by that.

21 MR. BEARD: The point is a broader one. It had a particular resonance there, but the point is a
22 broader one. It goes back to what I have already started to do. One has to look at the report
23 in 2009 and the 2011 decision as a whole and it is obviously right that Mr. Green can pick
24 out different paragraphs and look at them and forensically analyse them, but this decision
25 simply says that the Tribunal must be extremely cautious about placing undue weight on
26 particular phraseology. It is no more than a common sense exhortation as to how to read
27 these things.

28 THE CHAIRMAN: I think we have got the point, and it is, as you say, a familiar general
29 principle, not just in this area.

30 MR. BEARD: The final legal point I wanted to raise was just on the margin of discretion that the
31 Competition Commission has in relation both to the assessment of an AEC but also in
32 relation to remedial consequences and the proportionality of those consequences. Mr.
33 Green tried to insinuate that somehow by referring to a margin of discretion the
34 Competition Commission was being defensive. But it is not at all. All the Competition

1 Commission is saying is that there is a particular institutional competence that is conferred
2 on the Competition Commission in relation to these important matters. It empanels a body
3 pursuant to the statutory scheme to deal with it. We have quoted in our submissions *R v.*
4 *Director General Telecom ex parte Cellcom* . It is para.26 of the judgment at authorities
5 bundle 1 tab 14. I can take you to it. All it says is:

6 “If (as I have stated) the court should be very slow to impugn decisions of fact
7 made by an expert and experienced decision maker, it must surely be even slower
8 to impugn his educated prophesies and predictions for the future.”

9 Again, it may be thought by the Tribunal just to be a matter of common sense, but it is clear
10 the Competition Commission in the institutional framework is charged with carrying out its
11 assessment of evidence and factual matters when deciding what sort of investigations to
12 carry out in order to carry out its investigations. It has to make those sorts of educated
13 prophesies and predictions about how things are going to go. In circumstances where we
14 are dealing with common ownership of airports, where, as has been repeatedly emphasised
15 in the report, you cannot tell how competition is going to work at the time you are making
16 that assessment, in those circumstances it is right that the Commission must be afforded a
17 broad margin of appreciation/discretion in the way that it assesses both whether or not there
18 is an adverse effect on competition and whether or not the remedies it is seeking to impose
19 will be proportionate. Of course, it must take into account material considerations, of
20 course it must leave out of account irrelevant considerations. But in assessing those
21 considerations it does have a broad margin of appreciation.

22 I am about to move on to the criticisms in ground one. I am conscious of the time.

23 THE CHAIRMAN: Shall we take our break there. Five minutes.

24 (Short break)

25 THE CHAIRMAN: Yes, Mr. Beard. May I just mention because we lost a bit of time this
26 morning we are proposing to take a truncated lunch break. We will come back at ten to 2,
27 just to give everyone a little bit more time.

28 MR. BEARD: I am most grateful. I will try to speed up. Just dealing with ground one, to try to
29 distil out what we understand to be the four criticisms that are levelled at the 2009 report
30 and the 2011 report. What we understand them to be is that the first one is that the 2009
31 report was really all about new runway capacity, or competition considerations were all
32 about new runway capacity, or at least that was the overwhelming theme of the 2009 report,
33 and that when it talked about new runway capacity and competition in relation to it, it was
34 talking about competition in anticipation of the new runway capacity, or competition with

1 the new runway capacity in place. Otherwise, there was not a dynamic of competition
2 being identified in the 2009 report.

3 The second criticism is that Stansted was never really a significant constraint on Heathrow
4 so there is no need to require divestment, certainly not in 2011 because Gatwick has already
5 been divested.

6 The third criticism was that regulation really was enough here, and you did not need
7 divestment of Stansted in 2011.

8 Then partly based on these points, there was a series of particular criticisms about the
9 particular heads of benefit considered in the 2011 decision. I am just going to work my way
10 through those criticisms, which I hope are fairly distilling out Mr. Green and BAA's
11 submissions. All of them, we say, are without any merit whatsoever.

12 Just turning to the first, that the 2009 report was all about new runway capacity and
13 anticipated competition, competition in anticipation of new runway capacity. It is perhaps,
14 to start with, worth taking a step back. It would be a fairly remarkable proposition that in
15 the 2009 report the Competition Commission was saying that competition only really
16 existed between these airports, or potentially existed between these airports, in relation to
17 one dimension: the development of new capacity. It is not the sort of thing you would ever
18 anticipate a regulator dealing with competition issues would ever say. There is only one
19 way that three huge airports can compete against one another, so it is inherently unlikely.
20 As I have already mentioned, it would be particularly odd in circumstances where Gatwick
21 (one of the three airports considered) was not going to be subject to any development of
22 new runway capacity at all.

23 But it is also worth drawing to the Tribunal's attention the fact that in the 2009 report, even
24 in relation to new runway capacity, there was not this degree of absolutely certainty that Mr.
25 Green's case is essentially predicated on. Actually, there was a good deal of uncertainty
26 about whether or not even new runway capacity, as expected, would come to fruition.

27 Could I ask you to turn up the report in the introductory section para.4 right at the front of
28 the document. Paragraph 4 talks about the principal objective of government in privatising
29 BAA and there were concerns about inadequate capacity, particularly runway capacity in
30 the south-east which is something that we see again later on in the report and in particular in
31 section 9. The last sentence:

32 "There is as yet no certainty on the implementation of plans for additional runway
33 capacity at either Stansted or Heathrow, the earliest date for which is unlikely to
34 be before 2017."

1 So it is not a presumption of certainty that the new runway capacity is going to be
2 developed. Just for your notes, similar points are made in the report at para.4.15(c), 10.38
3 and 10.170. So there is this recognition that actually the timing or even the fact of new
4 runway capacity is not to just be assumed because there are other hurdles - planning and
5 environmental hurdles - that have to be got over in any event. So it is particularly odd if the
6 whole of the analysis was then based on new runway capacity.

7 The other thing that I think is perhaps important to draw out at the outset is we heard a lot
8 from Mr. Green about how the 2009 report was all about increasing new capacity and how
9 competition could only arise where there was an expectation of new capacity at the very
10 least. But BAA in its submissions never actually points up what the Competition
11 Commission was talking about when it talked about capacity. There is a danger of
12 conflating capacity with runway capacity. Of course, runway capacity is a very important
13 factor in an airport's capacity overall, but it is not the only factor.

14 In that regard, it is just worth turning Appendix 4.1. Appendix 4.1 is not exciting, but it sets
15 out the determinants of what it refers to as "technical airport capacity". You will see at
16 para.1 it says:

17 "The purpose of this appendix is to describe the various dimensions relevant to the
18 assessment of air transport capacity. Air transport capacity includes the following
19 aspects: (a) airport capacity - both landside and airside; (b) airspace capacity... [if
20 you have got a lot of airplanes coming in in close proximity that can create
21 difficulty]; (c) aircraft capacity [because of course the number of passengers you
22 can get through an airport will depend on the size of planes you are running
23 through. Even if City airport was running lots and lots of flights one after the
24 other, it can only accommodate very small planes given runway size and so on and
25 in those circumstances it will never be able to meet the sort of capacity that an
26 airport which can carry larger planes would]; and (d) surface access capacity
27 [which is transportation links and so on]."

28 When it comes to airport capacity itself, which is obviously the focus and the concern, you
29 will see at para.3:

30 "Airport capacity is generally defined across two dimensions: the number of
31 passengers, and aircraft movements which at BAA's airports primarily consist of
32 ATMs [air traffic movements, landings of takings off of aircraft]. The number of
33 aircraft movements that can be operated from the airport is mainly derived from

1 the number of runways and taxiways, the availability of stands and airspace
2 capacity.”

3 So a range of factors there but clearly runways are very important in setting the maximum
4 number of ATMs.

5 “4. The number of passengers that can be handled by the airport is driven by the
6 size of the terminal, the allocation of terminal space to the processing of
7 passengers and the number of staff allocated to the processing of passengers. It is
8 also driven by the investment of airlines in larger aircraft and the suitability of the
9 airfield (including runways and taxiways) for various sizes of aircraft.”

10 So the point is a simple one. One has to be concerned when one is talking about new
11 capacity throughout the report that you are not just talking about new runway capacity.
12 This appendix then goes on to talk about factors at terminals, airfield, runways, taxiways
13 and so on, but the point is nonetheless important. You cannot conflate new runway capacity
14 with other new capacity. Clearly, there may be some scope for increasing capacity without
15 increasing runways. Indeed, at various points in the report it is noted that actually capacity
16 at the London airports has increased massively over the last 20 years but there has been no
17 new runway development. That is partly because of more efficient ways of dealing with
18 aircraft and dealing with passengers. After all, what we will see when we come on to the
19 capital expenditure issues is there has been massive capital expenditure, for instance in
20 terminals at Heathrow and so on. But of course, no new runway there at all and that does
21 accommodate more people going through.

22 So the point is therefore that one has to look at the report bearing in mind both the fact that
23 it would be inherently implausible for it all to be focused on new runway capacity, and
24 actually the terms that are being used encompass not just new runway capacity but other
25 capacity as well.

26 THE CHAIRMAN: Mr. Beard, sorry, just so we hear what you have to say about it, I think one
27 of the paragraphs Mr. Green relied upon quite heavily was para.10.117 in particular its final
28 sentence about no change in government policy to be anticipated that would be so radical as
29 to invalidate the effectiveness of our remedy. I just wondered what your comment on that
30 sentence might be.

31 MR. BEARD: It is not clear precisely what is being talked about in the radical change. It is not
32 saying here simply no new runway capacity. That is not what it says. It talks about
33 government policy radically altering all of the relevant parameters to render the
34 arrangements ineffective, and therefore of no merit whatsoever. There is nothing in the

1 remainder of the report, when read in context, that suggests that if new runway capacity
2 were to be foreclosed in relation to the two pending proposals, not certain but pending
3 proposals, on the third runway at Heathrow and second runway at Stansted, that that would
4 render ineffective the remedy. That is not the conclusion that one can draw from that single
5 sentence, nor is it what the words of that sentence say.

6 What they are saying is if government policy were such that you did not have any scope for
7 competition, then you would render the remedy ineffective. There is no doubt about that.

8 But it is not to be read as saying implicitly that the remedy is rendered ineffective if new
9 runway capacity development alone is constrained. It does not fit with the remainder of the
10 report at all. Far too much weight has been placed on that, and it is not a proper
11 interpretation.

12 THE CHAIRMAN: Thank you.

13 MR. BEARD: In this context I was going to take the Tribunal to Section 8 and Section 9 of the
14 report. I have already done that. Those sections spell out very clearly, in particular in
15 Section 9 paras.9.10 through to 9.12, that lack of runway capacity was identified as one of
16 the consequences of the AEC, but when one talked about the sorts of concerns that gave rise
17 to the AEC and the need for remedies, one was not just talking about new runway capacity
18 at all. Just to remind the Tribunal:

19 “We have shown that competition between airports can have significant adverse
20 consequences for the quantity, quality, location and timing of investment,
21 investment currently being determined according to the priorities resulting from
22 monopolisation rather than competition. This is particularly the case in relation to
23 runway capacity.”

24 So another part of the report not referred to by Mr. Green clearly suggesting it is not just
25 focused on new runway capacity, and further reinforces the response I gave in relation to
26 10.117.

27 Of course, 9.9 in that section is talking about quality, service quality benefits and pricing
28 that would accrue immediately. So not dependent on the new runway developments, even
29 when they are not certain. I can shortcut that. I will not go back through Section 9 any
30 further.

31 But I would like to turn to the proportionality assessment itself in 2009 in Section 10. The
32 other point to make is that Section 10 is all about the remedial consequences once the
33 dynamics of competition and the concerns about the adverse impact on that competition has
34 been identified already. We are dealing with remedies here. We started at 10.88. There we

1 have the heading “Proportionality of divestiture remedies”. I will come back a little later to
2 the costs of remedies section. If you turn on to para.10.104, what you have here are the
3 benefits of competition. Paragraphs 10.104 and 10.105 talk in very general terms about the
4 benefits of rivalry; the fundamental concept that competition can deliver benefits to
5 customers and consumers better than monopolisation and monopolisation with regulation.
6 What is perhaps instructive is that when we get to the bottom of 10.105 just over the page,
7 having quoted the points from the Competition Commission’s guidance that rivalry has
8 numerous beneficial effects: “prices and costs are driven down, innovation and productivity
9 increase, so increasing the quality and, more generally, the diversity of choice”, so not just
10 predicated on capacity and investment, a whole range of factors.

11 “Further, markets that are competitive generate feedback from customers to firms
12 who, in consequence, direct their resources to customers’ priorities. [Here we are
13 beginning to talk about investment.] In addition firms are encouraged to meet the
14 existing and future needs of customers as effectively and efficiently as possible. It
15 is where this process is hampered or otherwise hindered, by features of the market
16 that competition may be adversely affected.”

17 That is precisely what has already been found in the conclusions Section 9. It is just worth
18 noting:

19 “In Section 3, we observe these advantages of rivalry in our case studies of
20 competing airports (paragraphs 3.14 to 3.24). [I am going to go back to Section 3,
21 so if you will permit me, I will not divert directly on this.] In our observations of
22 BAA in Section 7 (paragraphs 7.4 to 7.139)...”

23 Again, I am going to go back to those, but just as I have already adverted to, Section 7
24 covers things like capex, service quality, efficiency. So what is being referred to here is the
25 general guidance about the nature of competition, and then it is saying: what we saw
26 through the evidence in Section 3 was various advantages of this rivalry arising from case
27 studies and so forth, and when we looked at the performance of BAA in Section 7 we also
28 identified a range of concerns about lack of competition. They were not just limited to new
29 runway capacity; they were related to whole range of other matters. They have done it by
30 cross reference, but that is no sin, and it does not in any way diminish the significance of the
31 points being made here.

32 Effectively, what the Commission is saying is: look, we know what sort of things one
33 expects from competition where it works; we have set that out in our guidance that we have
34 quoted. What we saw when we carried out the AEC investigation was that those were the

1 sort of problems we were encountering here. So that is not a limited finding related only to
2 new runway capacity.

3 It concludes:

4 “We note many of the disadvantages of a lack of rivalry, notably in the absence of
5 responsiveness to customers, quality of service deficiencies and a failure to ensure
6 operating excellence.”

7 Quite how those are said to be essentially predicated on an assumption of new runway
8 capacity is just not understood.

9 Then we move on through 10.106:

10 “... the benefits of divestiture in terms of addressing the detrimental effects of the
11 AECs are likely to be substantial in total and in comparison with the relatively low
12 relevant costs of divestiture.

13 “10.107. Calculation of the quantum of divestiture benefits is inevitably complex
14 and subject to uncertainty. Competition is a dynamic and inherently uncertain
15 process, and it is therefore difficult to anticipate precisely how competition
16 between the airports will benefit customers following divestiture. The uncertainty
17 is exacerbated in this case by the current absence of competition between BAA
18 airports and the shortage of direct comparators from which to extrapolate the size
19 of benefits that could be expected to result from competition between BAA’s
20 airports in the South-East and between Edinburgh and Glasgow.”

21 Those are points the Tribunal picked up in interaction with Mr. Green yesterday,
22 effectively, the latency of the benefits of competition because of the common ownership.
23 Of course, when we come on to it, when we look at service quality and capex, what we do
24 have now is, because of the divestiture of Gatwick, we have a natural experiment. We have
25 a natural experiment of how that competition might work and we have very clear
26 indications of the precisely the sorts of concerns that the Competition Commission had
27 about competition being suppressed and how it could be liberated by the end of common
28 ownership being indicated through that natural experiment.

29 Then 10.108 is to do with Glasgow and Edinburgh. 10.109:

30 “It is not possible to quantify the benefits of divesting the London airports given
31 the more complex interactions and the existing regulatory regime. However, we
32 estimate that on average the net benefits of competition for the London airports
33 would only need to exceed between 2p and 9p per passenger at Stansted or
34 between 2p and 7p per passenger at Gatwick on average over the next 30 years to

1 exceed our estimate of the maximum relevant costs of divestiture. As a broad
2 indication of the relative scale of the required benefits, these represent less than 2
3 per cent of the passenger charges at these two airports. We are therefore confident
4 that all the expected benefits described in paragraphs 10.64 and 10.66 will
5 outweigh the costs of divestiture and note that the development of competition,
6 even in a regulated market, can sometimes exceed all expectations, in terms of
7 both scale and speed.”

8 That is a footnote reference to the Commission’s experience following the separation of
9 activities in relation to British Gas.

10 If we just go back to 10.64 and 10.66 that are quoted there.

11 MISS STUART: In 10.109, where you say the benefits per passenger at Stansted or at Gatwick,
12 is that relating to the sale of both airports, or is it that it is 2p per passenger at Stansted, and
13 that relates to the divestiture of Stansted and the other one relates to Gatwick?

14 MR. BEARD: I will double check the numbers because I do not want to mislead the Tribunal. If
15 you look at footnote 20, Mr. Bates helpfully indicates:

16 “These calculations are based on one-off costs of divestiture of approximately
17 £28 million at Gatwick and approximately £23 million at Stansted, and the
18 benefits are shown net of any relevant customer benefits that would arise
19 continuing common ownership (the calculations are set out in Appendix 10.3).
20 As noted in paragraph 10.103, we consider that relevant customer benefits
21 arising from common ownership are unlikely to be significant.”

22 So what it is saying is that the cost of divestiture of Stansted would be outweighed by 2 to
23 9p, and 2 to 7p at Gatwick. If I am wrong in the interpretation of that I am sure those
24 behind me will correct me, and I will revert, but I believe that is the position. There is
25 nodding behind me, so I have got it right.

26 If I could just track back to 10.64 to 10.66 which are the paragraphs referred to there. I
27 think you have been taken to some of these paragraphs previously, but just seeing them in
28 context, “Our assessment reflects our view” – this is the overall assessment that a
29 divestiture remedy is required:

30 “... that the main business from the divestitures will result from the dynamic
31 aspects of competition. As we explain in Section 5, competition is a dynamic
32 process which drives prices and costs down ...”

33 Perhaps it is just easiest if the Tribunal reads those three paragraphs.

34 THE CHAIRMAN: Yes. (After a pause) Yes.

1 MR. BEARD: Undoubtedly, in relation to in particular 10.65 there is consideration there of the
2 long term benefits of new runway capacity becoming available and the benefits that will
3 accrue. The idea that that is all that those paragraphs is about just does not fit at all with
4 both the wording of 10.64 or the wording of 10.66, the way that they are referred to and
5 relied upon in the context of 10.109, and, as I have already mentioned, the presumption that
6 ran through Mr. Green's submission that all references to capacity here were always to do
7 with new runway capacity. Again, when we are looking at section 10, what we are seeing is
8 references to all of the dynamics of competition between these airports, not just in relation
9 to potential competition dependent upon expected new runway capacity.

10 Then of course we come to 10.110, which Mr. Green has already referred the Tribunal to.
11 Here, I think it is important just to stress:

12 "In the course of our recent review of airport charges at Stansted ..."

13 which is, he quite rightly said, for Q5 –

14 "... we have also identified illustrations of potential savings, resulting from
15 improved capital efficiency, the design of differentiated terminal facilities and
16 better control of staff costs as set out below."

17 It is worth noting again, not concerned with new runways.

18 "We consider that these illustrative savings would be delivered more quickly
19 and to a much fuller extent in a competitive environment and that airports under
20 separate ownership would have stronger incentives to deliver differentiated
21 facilities to meet the needs of their customers and to manage their project costs
22 more efficiently."

23 Now, (a) and (b) here are undoubtedly concerned primarily with new runway capacity at
24 Stansted, what is referred to as "SG2" in the jargon, but (c) and (d) are not at all. Those
25 illustrations are suggesting that actually those benefits will accrue more fully and faster,
26 (c) is in relation to what is called SG1, which is general capital investment at Stansted, not
27 related to new runway capacity; and (d) is in relation to particular aspects of operating
28 expenditure. So again, it is just extraordinarily difficult to understand how BAA could have
29 thought that the 2009 report was all about competition in anticipation of new runway
30 capacity.

31 If we go back to section 5, which of course Mr. Green did major on, the section about scope
32 for competition between BAA's airports, the consideration of BAA's London airports starts
33 at 5.6. Again I am conscious that the Tribunal has seen these paragraphs before, but having

1 taken the Tribunal to sections 8 and 9 and talked about the structure of how this report
2 works, it is worth just revisiting some of these paragraphs. 5.10:

3 “From the outset of the inquiry, BAA argued that the key issues in assessing the
4 potential for competition between its London airports were capacity constraints
5 and price caps.”

6 It is worth just pausing there. BAA were arguing throughout the 2009 inquiry there was not
7 really competition because of all the constraints and because there was not any need for
8 anything else to be done because you have price caps and regulation in place.

9 In particular, the price caps argument is saying, “If people are pricing up to the price caps,
10 there is not any room for competition at all here”. So that was actively considered by the
11 CC at that time and it is rejected in 5.10. It is not rejected just in 5.10, because as you can
12 see from (a), “As discussed in section 4” there is a discussion about how the way in which
13 BAA is operated has actually exacerbated delays in relation to runway capacity and
14 constraints that flow from it.

15 Then (b):

16 “In the absence of common ownership and capacity constraints, the market
17 position at least of Gatwick and Stansted would, in our judgment, not be such as
18 to require price caps.”

19 In other words, this common ownership arrangement has actually engendered the things that
20 BAA rely upon as stymieing competition. The CC is saying that that is effectively a
21 bootstraps argument and you cannot rely on that. In any event, you have got broader
22 competition concerns in play. We see that in particular in 5.12 through to 5.14.

23 Of course you have seen these paragraphs and there was some degree of discussion with
24 Mr. Green about them. 5.12:

25 “We set out in Appendix 5.1 our assessment of the potential for competition
26 between BAA within existing constraints. In summary, even within these
27 constraints we consider that airports can rival each other in improving service
28 quality and compete to retain valuable users, eg airlines that bring a high
29 number of passengers per ATM or passengers who contribute
30 disproportionately to retail revenues.”

31 In other words, competition, it is just another dimension of competition. It might be that
32 you want to go for low cost, low fares people who you can get through very quickly, or you
33 might want to go for business passengers, who are going to come through, or there might be
34 a category of passengers who, knowing there is a retail estate at the airport, think,

1 “Actually, we will go along early and we will do our shopping in advance”, because you
2 would generate revenues in a range of ways. They are looking at the whole gamut of
3 competition dynamics here. Indeed, Mr. Green at one point did suggest that he did accept
4 that these were ----

5 THE CHAIRMAN: My understanding of his submission, and he can tell me if I am wrong, is that
6 he accepted that 5.12 to 5.14 in Appendix 5.1, subject to one point, were all predicated on
7 the basis that existing constraints continued, i.e. no expectation of future runway. The one
8 point, as I understood it, was the new amendment submission by reference to the CAA
9 report, as to which I have already given an indication. Mr. Green, that is a fair
10 understanding, is it?

11 MR GREEN: Yes.

12 MR. BEARD: I just wanted to be clear because it was not clear to us whether or not there was a
13 more general resiling from the position on Monday. I do not perhaps need to labour the
14 point further in relation to 5.12 to 5.14.

15 THE CHAIRMAN: I do not think so.

16 MR. BEARD: I would just also note 5.15, which is clearly also talking about broader provisions.
17 Then, if you go on to 5.17 ----

18 THE CHAIRMAN: You need to be a little bit careful of those, because if you look at the
19 sentence in parenthesis at the end of 5.12 that seems to be to indicating that 5.12 to 5.14 is
20 talking about one set of effects, and then 5.15 to 5.37 is talking about how competition
21 would develop.

22 MR. BEARD: I think the caution we express is actually linked to the point I made about capacity
23 more generally. Here you have a situation where you are talking about the existing
24 constraints as they are at all the airports, is there any way for strategies to flex the way that
25 people operate. There is a degree of ambiguity about whether or not that means that the
26 existing constraints referred to in 5.15 through to 5.17 must mean alleviation of new runway
27 capacity constraints only, or whether or not it can be in relation to other capacity
28 constraints. If so, then of course what you have is a situation where 5.15 and some of the
29 points in 5.17 – I am not saying all of them, because clearly the latter two points in 5.17 are
30 specifically talking about new runways.

31 THE CHAIRMAN: It seems to me that 5.12 to 5.14 are addressing a situation, let us suppose,
32 where there is no anticipation of new runways, and they are saying there is scope for market
33 competition even on that premise. 5.15 then adopts a wider predicate that there may be
34 future runway capacity but talks compendiously about the development of competition in

1 the light of that, which will include the competitive effects identified at 5.12 to 5.14. There
2 is no suggestion they drop out of the picture, but a wider scope for competition or degree of
3 intensity of competition informed by expectation of new runway capacity as well.

4 MR. BEARD: I am not demurring because clearly 5.17 is talking about ----

5 THE CHAIRMAN: It mixes it up.

6 MR. BEARD: It mixes the two things up. The point is (a) capacity is referred to, you cannot
7 assume it is new runway capacity; and (b) Mr. Green's argument is predicated on an
8 assumption that all of this further discussion means that any of the competition concerned
9 depends on the new runway capacity existing. It is not clear at all that that is a proper
10 reading of those paragraphs.

11 Undoubtedly, when you come on to section 5.20 onwards, where the development of
12 competition between London airports is concerned, what the CC then does is it discusses
13 how it broadly expects things to work in the world where there is an expectation of new
14 runway capacity. There is no doubt about that. That is clear from the terms of those
15 various paragraphs that Mr. Green took the Tribunal through.

16 It is worth just making a couple of points even in relation to that section, because of course
17 there is a slight irony that some of the points about the development of competition here are
18 interesting in relation to new runway capacity, because of course at 5.27 it is talking about
19 the fact that, actually, the next round of runway capacity is settled and you will not get
20 competition in relation to that, but nonetheless the CC goes on and says you could have
21 competition overall.

22 5.30 is talking about general infrastructure changes. Again, it is not to be assumed that
23 those general infrastructure changes must be predicated on the expectation of new runway
24 capacity, albeit that, clearly, when it is thinking about those matters new runway capacity is
25 in its mind.

26 Then, just on 5.34, it is a passing point, but Mr. Green at various times emphasised how the
27 long term contracting benefits for airports would arise when you had new runway capacity
28 coming on stream, and you would get this flexing of the level of capacities that you would
29 want to iron out uncertainty. It is just worth noting that at the end of 5.34 there is a
30 reference to the case study in relation to Liverpool, which I am not going to take you to (it is
31 actually in appendix 3.3), but what it says there is that there were contractual arrangements
32 entered into in order to deal with problems of uncertainties, and so on, for the relevant
33 airlines. Those were in relation to new terminal facilities. It was not in relation to new
34 runway capacity, because there was not new runway capacity being built at Liverpool.

1 THE CHAIRMAN: Did they have spare capacity on their existing runway?

2 MR. BEARD: Yes, they did have spare capacity.

3 THE CHAIRMAN: I am not sure what point you are making about Liverpool then, because if
4 they had spare capacity on their existing runway that is equivalent to London with new
5 runway capacity.

6 MR. BEARD: The only point that I am making is that the sort of long term contracting
7 arrangements that Mr. Green was referring to are not just going to be relevant in
8 circumstances where you are talking about increased runway capacity. You can have those
9 sorts of arrangements put in place in relation to, for instance, use of new terminal facilities,
10 which is what was going on at Liverpool.

11 One of the dynamics you can have is, because you can have a whole range of ways in which
12 airports can change what they are offering, you can have all sorts of contracting
13 arrangements, long term and short term contracting arrangements, being put in place, and it
14 is not right simply to say, “You will only have long term contracting arrangements put in
15 place between airlines and airports”, or more particularly innovation in terms of dealings
16 between airports and airlines when you have new capacity or spare capacity available. It is
17 no more than that.

18 I am not trying to resile from the position that (a) the Competition Commission in looking at
19 these things thought that new runway capacity would be available. That was the reasonable
20 expectation, although it was not certain when it was dealing with this section on how it
21 thought competition would develop; nor am I suggesting that they thought it was
22 unimportant. They were not saying that at all. That does not alter the overall appraisal of
23 the report one iota.

24 THE CHAIRMAN: The very fact that they identify, themselves, change in government policy as
25 an MCC emphasised that it was important in the 2009 report.

26 MR. BEARD: Exactly right, and it is also true in relation to regulation, and I will come on to
27 that. You have obviously seen 5.42 which is the summary in relation to section 5. Of
28 course, what that says is what is inconsistent with the general theme that I have been
29 developing in terms of what is seen in the report:

30 “Common ownership is a feature of the market preventing competition between
31 the three London airports; the extent of that competition may be limited by
32 current capacity constraints and price control, but these constraints are
33 themselves at least in part the result of common ownership. We have set out
34 how we expect competition between the airports to develop ...”

1 It is talking about the extent of competition. It is not saying that there is no competition
2 between airports simply where you do not have new runway capacity envisaged.
3 Then, of course, we have Appendix 5.1, and, frankly, the terms of Appendix 5.1 just could
4 not be clearer. It sets out a series of examples about how competition might work within
5 current constraints. It is not pretending to be exhaustive.

6 The CC has constantly emphasised how it cannot tell how competition will play out. It
7 specifically talks about some of the strategies that might be adopted, and of course it does
8 set out these points from the CAA – I am not going to make submissions about the CAA
9 document itself – but those points, they frame the whole of this document. What this
10 document is saying is these are the sorts of dynamics of competition that one can see. Then
11 it goes on and says, “These are some particular examples we identify in this regard”.

12 I will not go through Appendix 5.1 in any great detail unless the Tribunal wants me to
13 because I am conscious that the Tribunal will have read it and is well aware of it, and the
14 proposition is plain and obvious. It sets out a range of dimensions or strategies that may be
15 followed in relation to competition, the off-peak competition between Gatwick and
16 Stansted, competition to increase passenger numbers at Heathrow and Gatwick, scope for
17 competition on service quality. Then the one that Mr. Green did not major on because it is
18 relatively brief, scope of competition through differing commercial strategies between
19 Heathrow, Gatwick and Stansted. This is rather important ----

20 THE CHAIRMAN: Where is that?

21 MR. BEARD: I am sorry, it is on the last page, it is paras.20 to 21. In a way, it is a sweep up of
22 what was identified in paras.3, 4, 5 and 6 as being the broad parameters of competition. If
23 you have got differing incentives to operate your airport because you are in separate
24 ownership, the CC does not presume to know the creativity, dynamism and new
25 management teams competing vigorously against one another for airlines and passengers,
26 and that can be in relation to all of the dimensions identified in those CAA points recited in
27 para.3. That may well be in relation to new developments of infrastructure and capacity
28 which are referred by the CAA, and that is not limited to new runway capacity. It is
29 different ways of investing, different ways you spend your money in order to win business
30 and win business from others. So it should not be narrowly construed, Appendix 5.1, it
31 gives some particular examples that are perfectly sound, but actually ----

32 THE CHAIRMAN: When you say not “narrowly construed” – again, I just mention this lest I
33 have misunderstood what Mr. Green was submitting – I understood him to accept, subject to

1 the CAA's report point which we have given an indication on, that all of 5.1 is predicated
2 on there being no expectation of additional capacity.

3 MR. BEARD: I am sorry, I am anticipating submissions in relation to ----

4 THE CHAIRMAN: Mr. Green is nodding, so I have understood that part of his submissions.

5 MR. BEARD: The only point I am making is I am anticipating dealing with the submission that
6 says, "You did not discuss capex, you did not discuss various components of competition
7 benefits in Appendix 5.1 and therefore somehow they cannot be counted in 2011". The
8 point I am making is actually Appendix 5.1 is broader in its terms in contemplating what the
9 sorts of benefits might be and the ways in which the dynamics of competition might work.
10 The case does not hinge on it in any event because it is an appendix, and actually you see
11 references to capex and opex and service quality, and so on, through the main part of the
12 report, and I will come on to that, but I just thought, whilst we were here, I would
13 emphasise the point.

14 Those are the key points in relation to the 2009 report. There is one final point to make
15 about the first criticism that the 2009 report did not focus on competition absent new
16 runway capacity being expected. Even if that were the case, does it prevent the CC from
17 actually considering these matters as to the benefits of competition that it identified in 2011
18 in any event? Clearly the 2009 report does talk about the dynamics of competition, and the
19 fact that in 2009, if Mr. Green was right that it was not focusing on these particular
20 dimensions, it is not clear that it would make any difference. I only make that point as a
21 matter of legal completeness. It is not germane because the interpretation of the 2009 report
22 is absolutely plain and covers all these issues. Nonetheless, it is just worth having that kind
23 of reality check in relation to what can and cannot be done in relation to the 2011 decision.
24 I am going to move on to the second criticism that Mr. Green levelled at the CC in the
25 context of ground one, and that was that the 2009 report considered the benefits of the
26 divestiture of both Gatwick and Stansted, whereas the 2011 decision was taken in
27 circumstances where Gatwick had already been sold. Because Gatwick was already then
28 providing the competitive pressure to Stansted/Heathrow joint BAA entity, there are no
29 additional benefits from competition from also selling Stansted.

30 The first point to make in relation to this is that it is difficult to see where that observation
31 takes Mr. Green in any event, because the divestment of Gatwick formed part of the
32 remedies identified in the 2009 report. It was necessary for remedying the AEC of common
33 ownership, but that report also went on and said expressly that in order to remedy the AEC
34 effectively Stansted also needed to be divested. So it was looking at the relevant

1 incremental differences. Whether you look at it as Gatwick first and then incremental
2 benefits of Stansted, or Stansted first and relevant incremental benefits of Gatwick, those
3 were matters that were canvassed in the 2009 report. So the idea that somehow there is
4 something missing and that actually the 2011 decision somehow should reformulate all of
5 this and reconsider it because actually the 2009 report was proceeding on some other basis
6 is just plain wrong.

7 I think the Tribunal probably already has the point, but could I just take you to section 10,
8 para.10.46, which is one I briefly directed the Tribunal to earlier. It comes in a section
9 which starts at 10.40, and just for your notes it is entitled “The incremental competition
10 benefits of divesting Stansted in addition to Gatwick”. So it is considering precisely the
11 question that Mr. Green says is relevant, and the Competition Commission thought it was
12 relevant. If the Competition Commission thought, well, getting rid of one these airports and
13 putting it in separate ownership that would give enough competition to solve the AEC then
14 that would be what will be done, because obviously requiring two would be unduly onerous
15 and unnecessary.

16 After having canvassed some of the evidence at 10.46 what the CC does is it specifically
17 says that there is adverse effect on competition by that common ownership of Stansted and
18 Heathrow together. It goes on to consider how that interaction works. It refers back to the
19 evidence on substitutability, which is dealt with in section 3, and at 10.47 it says:

20 “... although most airlines currently using Heathrow and Stansted would not
21 view the other as a close or effective substitute, a significant number of their
22 non-transfer passengers do.”

23 You have already heard how competition in relation to airports is effectively based on
24 derived demand – in other words, airlines demand things because passengers demand
25 things.

26 “In particular, the catchment analysis, the competitor analysis and the survey
27 data that was collected by BAA and CAA indicate that for this group of
28 passengers, Heathrow is the second-closest substitute to Stansted (after
29 Gatwick) and Stansted is the second-closest substitute to Heathrow (after
30 Gatwick).”

31 Just in passing, Mr. Green at various times talked about, “You could have a close substitute,
32 but you were not very close”. That is a semantic distinction that I struggle with in these
33 circumstances, particularly when one actually looks at section 3, because what it is said is it
34 is very close, this substitution, there is no doubt about it.

1 One then carries on through this section, 10.48:

2 “We believe that substitution by non-transfer passengers would influence
3 decisions taken by the operators of Heathrow and Stansted. Most passengers
4 using Heathrow and Stansted are local non-transfer (i.e. flying point to point)
5 ...”

6 The point that is being made is that, because Heathrow is a hub airport, there are all sorts of
7 people that come into Heathrow in order to transit to other places. Stansted does not have
8 the same range of destinations and therefore it is less of a hub airport for passengers. If you
9 are talking about non-transfer passengers, people that are not transiting, they are a relevant
10 comparator, because for them going to one London airport or another, as section 3, is likely
11 to be a close substitute. It is important that, lots of the passengers at Heathrow are non-
12 transfer passengers and there are lots at Stansted, because it heightens the degree to which
13 they are competitors. This is what 10.48 is talking about.

14 Then 10.49:

15 “We do not accept BAA’s view that airport operators cannot influence the
16 choice passengers make in relation to which airport they fly from or to. As set
17 out in Section 3 and Appendix 10.1, an airport operator could influence
18 passenger choice in a number of ways, for example through airport charges
19 which have an effect on the fares paid by passengers and through the quality of
20 the airport facilities which influence passenger choice.”

21 Of course, Mr. Green sought to suggest that actually passengers were all price insensitive,
22 which is perhaps relatively surprising, and he highlighted certain bits of section 3 to make
23 that supposedly good. It is not correct. As the Tribunal picked up, it does not make any
24 difference. Even if you have got price insensitive passengers they will be sensitive to
25 quality changes.

26 Then it deals with the points raised by BAA that:

27 “... excess demand at Heathrow precludes competition from Heathrow and
28 Stansted from emerging. This view ignores the dynamic element of rivalry and
29 the distortions that common ownership would give rise to in this respect.
30 Specifically, in adopting this view BAA overlooks the constraint Heathrow
31 could provide on Stansted. Our substitutability analysis indicates that initiatives
32 at Heathrow such as capacity expansions and/or improvements in service
33 quality would affect passenger numbers, airline performance and ultimately

1 airport performance at Stansted. This view is supported BAA's own modelling
2 ...”

3 That modelling, it should be stressed, was in relation to new capacity.

4 “We would therefore expect Heathrow to have a greater incentive to expand
5 capacity and invest in productive capital if Stansted were divested in addition to
6 Gatwick, with pro-competitive effects. For similar reasons, we would also
7 expect Heathrow to face greater incentives to increase service quality or
8 restructure prices so that it could out-perform its passenger number forecasts if
9 Stansted were also divested, although we accept that the effect of tariff changes
10 within the price control is likely to be modest. This would also be expected to
11 have a pro-competitive effect upon the terms offered by Stansted.”

12 So what we have got here is an analysis of bilateral competition, not even trilateral
13 competition, but clearly an assessment that there was an AEC of common ownership
14 between Heathrow and Stansted, it was significant and bilateral competition was being
15 stymied.

16 Then 10.51 talks about Stansted beginning to operate as a hub and that would be a long term
17 project. Then 10.52 is specifically about a second runway, no doubt about it. 10.53 is
18 talking about the general point that is being made repeatedly, that they do not know
19 precisely how competition is going to work, but we do consider that, even given the
20 distorting effects of government policy and regulation, there are significant restrictions on
21 competition between the two.

22 “10.54. We therefore consider that the divestiture of Stansted, in addition to the
23 divestiture of Gatwick, is required to address the AECs we have identified.”

24 Just to take you to a couple of sections of the report that are referred to here and on the basis
25 of what is going on, I think it is useful at this point to turn back to section 3. If we start at
26 the beginning of section 3, this is the analysis of substitutability between BAA airports, both
27 the Scottish ones and the London ones. Mr. Green raised a number of criticisms in relation
28 to this, and we note in passing that it is difficult to see how any of the criticisms he raised
29 really go an MCC issue. What he tried to do was dismiss this substitutability analysis by
30 focusing on certain bits of it. He actually just ignored the central part of the analysis in his
31 dismissal. If one starts at 3.2, what you have is a statement of what the CC are doing here:

32 “Assessing airport substitutability is an important step in our competitive effects
33 analysis because substitutability is central:

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

3 Obviously, if you have market power you may not necessarily set terms and conditions
4 optimally as would occur in a competitive market.

5 “(b) assessing the additional market power held by BAA as a result of its
6 common ownership of many airports.”

7 This is clearly identifying who it is that the common ownership impacts.

8 Then 3.3 is a paragraph you have seen before about the dynamics of competition. Just for
9 your note, in a discussion with Mr. Green – there are three dynamics of competition that
10 may be affected by market power. First, there are changes in behaviour by airlines:

11 “Second, even when switching by airlines is not possible, changes in passenger
12 behaviour may constrain airports due to the ‘derived’ nature of airport demand.”

13 I think you pointed out, Mr. Chairman, that that meant that the second and first issues are
14 linked.

15 THE CHAIRMAN: I think that showed that I had not read the report thoroughly enough, because
16 that is what is said in 3.4.

17 MR. BEARD: It is in 3.4, but if it helps just for a description of “derived demand”, for your notes
18 is at 2.2 in the report. There is a discussion of direct effects and indirect derived effects as
19 to how competition works. I do not think I need to take you to that, I think you have the
20 point in relation to that.

21 If one turns on, what you get just above para.3.14 is a heading saying “Evidence on
22 competition between separately owned airports”. What the Commission does first is look at
23 how does competition work when you have separately owned airports, and it refers at 3.15
24 to the CAA's study of regional air services. I make clear, these studies are concerned with
25 airports that do have spare capacity, no doubt about that, but nonetheless what the
26 Commission was doing was looking at how do the dynamics of competition work? Are
27 they limited, are they in a range?

28 Then, if you turn over the page, just above 3.17 what you have are case studies. The CC
29 then went and looked at various particular case studies as how it understood competition to
30 be working in relation to airports which were under separate ownership. Those are
31 discussed in much more detail in Appendix 3.3, but you can see that there four sets of case
32 studies considered. There is a reason why it is worth highlighting that a little later.

33 We have the case studies and there are conclusions drawn in relation to those about the
34 nature of competition.

1 Then, having looked at the thing in more general terms and looked at that sort of evidence,
2 the Commission moves on just above 3.25 to “Actual and potential competitive constraints
3 on BAA airports”. Here it spells out in 3.25:

4 “In this section, we set out our findings in relation to substitutability involving
5 BAA’s airports. In the line with the approach we have outlined above, we have
6 considered the substitutes for each airport from the perspective of both
7 passengers and airlines. For convenience we have separated the Scottish and
8 South-East airports. We have identified the closest substitutes to each of
9 BAA’s airports: if the close substitutes for BAA’s airports include other BAA
10 airports, this suggests that BAA has acquired additional market power as a
11 result of common ownership of many airports.”

12 Then it highlights the point:

13 “To date, there has been no competition between any of BAA’s airports. As we
14 discuss in paragraphs 3.27 and 3.28, this has two important consequences:
15 (a) There can be no direct evidence of airlines or passengers switching between
16 BAA’s airports in response to airport competition. However, we can and have
17 collected evidence on the characteristics associated with airports that do
18 compete. This has enabled us to identify some of the main drivers of
19 competition and to collect some benchmarks against which to compare BAA’s
20 airports.”

21 So that is an explanation of, to some extent, what they were doing earlier. Then:

22 “(b) Common ownership itself seems likely to have affected the way in which
23 BAA operates its airports. For example, BAA might not have operated or
24 marketed the airports as substitutes for one another and instead may have
25 marketed its airports as complementary to one another so as to prevent growth
26 at one airport cannibalising growth at another. If this were the case, BAA’s
27 airports could appear to be less close substitutes than they would under separate
28 ownership. This means that some of the analysis that we present in the
29 following section may underestimate the degree of substitutability between
30 BAA’s airports, although less so in the case of Heathrow and Gatwick where, as
31 we note below, capacity constraints and regulation make the relationship more
32 complicated.”

33 If you turn over the page, it then sets out a range of material that they consider, “Passenger
34 data”, and at 3.31 there is a reference to some of the surveys conducted by the BAA and the

1 CAA, which Mr. Green did refer to, there is some airline evidence which he did refer to,
2 and some other evidence.

3 The first part that is referred to in 3.30 about CAA data analysis is the part that he skipped
4 over. This section begins by considering the analysis of that data in relation to the BAA
5 Scottish airports.

6 Mr. Chairman, during the course of the consideration of the section on inter-airport
7 exposure very briefly with Mr. Green, you asked where the methodology was that led to the
8 various graphs, and so on, and I misunderstood what you were asking for and gave you the
9 conclusion paragraphs. The paragraphs that I think are needed are 3.39 and 3.40. This is
10 taking the CAA data which enables you to identify where passengers at different airports
11 came from, so where they live ----

12 THE CHAIRMAN: Can we just read those to ourselves?

13 MR. BEARD: Yes, please.

14 THE CHAIRMAN: (After a pause) So does it work in this way: that the CAA conducts surveys
15 of passengers saying, "Where do you live, why are you using this airport", that sort of
16 thing?

17 MR. BEARD: Less of "Why are you using", although I think that is one of the surveys. "Where
18 do you live, which airport are you using?" is the crucial data for this analysis.

19 THE CHAIRMAN: So that gives you the information to look at airport catchment areas?

20 MR. BEARD: Exactly.

21 THE CHAIRMAN: (After a pause) I see, so this does actually explain what the district share
22 thresholds are?

23 MR. BEARD: Yes, exactly. Although it is talking about Scottish airports, this is the
24 methodology applied throughout.

25 THE CHAIRMAN: Let me finish reading. (After a pause) I have read that. How do they derive
26 the district share thresholds?

27 MR. BEARD: I think initially in some previous working papers they have set out a district share
28 threshold of 20 per cent as being significant. If I take you to some of the graphs I can just
29 indicate that actually they do not pick a particular district share threshold as being crucial,
30 they look at the shape of the total exposure of passengers at different district share
31 thresholds.

32 THE CHAIRMAN: I will be quiet and you keep going and it will become clear.

33 MR. BEARD: The important thing to note in 3.39 is the rationale for what they doing as well as
34 the methodology. What they are trying to do is look at the level of exposure that passengers

1 in a particular district have to different airports – in other words, how they could choose to
2 go in different directions, and therefore which passenger groups these airports could
3 compete for and the extent of that overlap. They are not using what is referred to isochrone
4 analysis – the Tribunal is probably with isochrone analysis ----

5 THE CHAIRMAN: You tell us what it is.

6 MR. BEARD: Isochrone analysis is just an equal time from a particular destination. It was
7 particularly used in relation to an analysis of supermarkets where you drew isochrones
8 round a particular supermarket and decided how much competition there was within the
9 isochrone and how they overlapped, and so on. What they are saying here is, "We are not
10 just doing drive times from particular airports, because actually their pattern of overlap
11 might be rather different given that there are three of them around London and actually they
12 might have wider catchment areas, so it is a more sophisticated analysis in that regard, or at
13 least better designed to capture what they want to deal with."

14 Initially the analysis in this section is dealing with Scottish airports. If you turn on to p.66,
15 or para.3.86 it starts dealing with BAA's south-east airports. It does not repeat the
16 methodological points, but it is clear that they are carrying out the same exercise. At 3.91
17 they talk about this catchment area analysis, and in fact there is a whopping great appendix
18 on all of this at 3.5, which I do not need to take you to, you may be pleased to know. Then
19 they talk about the inter-airport exposure analysis.

20 What I was going to do, if you turn over the page to figure 3.8, is illustrate how this analysis
21 works, at least as I understand it and if I am getting it wrong I will no doubt be pulled out
22 from behind. If you look at the plot at figure 3.8 what you have along the horizontal axis is
23 competitive district share thresholds ranging from zero to 100. This plot is about
24 Heathrow's exposure to other London airports under district share thresholds at 0 to 100 per
25 cent. If you take, just for example, 20 on that axis what that is saying is that in districts
26 where at least 20 per cent of the passengers in those districts go to a rival airport, depending
27 on the particular plot you are dealing with, you will then read across the vertical axis and
28 work out how many of the total number of Heathrow passengers also come from those
29 districts. It is worth just doing it in relation to a specific plot. The light blue line, the first
30 one, the furthest left, is in relation to non-BAA airports. So again, if you take the 20 per
31 cent district share threshold, when you ask yourself which districts are there where 20 per
32 cent of the airport passengers go to non-BAA airports, the number of the Heathrow
33 passengers that come from those districts is actually around only 10 per cent.

1 Effectively, what you are saying is that passengers come to Heathrow from these districts,
2 but actually 20 per cent of the airport passengers in those districts go to non-BAA airports,
3 and actually you find that only 10 per cent of Heathrow's total passengers come from those
4 same districts. In other words, the degree of overlap between Heathrow and non-BAA is
5 relatively low in relation to those areas where a reasonable number of air passenger go to
6 non-BAA airports. So the level of competitive impact between Heathrow and non-BAA
7 airports is concomitantly low.

8 If you look at the next line, the grey line, that is non-BAA airports and Stansted. If you do
9 the analysis there, again at the 20 per cent competitive district share threshold, this a
10 cumulative line of passengers going to non-BAA and Stansted airports. If you look at that
11 line it is at around 60 per cent (roughly) of Heathrow's passengers come from districts
12 where 20 per cent of passengers either go to non-BAA airports or Stansted.

13 Then if you take the third line, the red line, and you do 20 per cent district share threshold,
14 what you find is that cumulatively between non-BAA and Gatwick, because LGW is the
15 airport code for Gatwick, you actually find that almost 100 per cent of Heathrow's
16 passengers come from those districts where Gatwick or a BAA airport takes 20 per cent of
17 air passengers.

18 If you want to identify how much exposure there is just from Stansted or just from Gatwick,
19 effectively you plot the difference between the blue line and the grey line. So, for Stansted,
20 since that is what we are focusing on, it is the gap between the blue line at 20 per cent and
21 the grey line at 60 per cent. So it is about 50 per cent for Stansted.

22 What you are doing here is looking at this catchment area analysis and looking at the degree
23 of competitive pressure effectively that could be brought to bear in relation to it.

24 These graphs are repeated in relation to each of the airports and obviously are salient in the
25 analysis, and important to the conclusions that are finally reached.

26 As I say, the core part of the substitutability analysis is looking at real data as to where
27 passengers actually go. It is trying to get beyond the problems of the difficulties that arise
28 because of the existing common ownership. That is why this analysis is of particular
29 importance. For those that are familiar with the competition market share analysis, it is a
30 much more sophisticated way of dealing with these sorts of problems than ordinarily would
31 be dealt with.

32 There is just one other plot I would ask the Tribunal to turn on to, figure 3.11, p.71. This
33 one is a whole range of lines. It is "Comparison of findings on airports' exposure to one
34 another – BAA's London airport vs. Birmingham's exposure to East Midlands;

1 Manchester's exposure to Liverpool and Manchester's exposure to Leeds Bradford". You
2 might ask why on earth would you bother plotting out these relationships? The explanation
3 is actually in 3.98, because having looked at the extent to which there is significant overlap
4 between the catchment areas for Stansted and for Gatwick and Heathrow, which suggest
5 they are strong and close competitors to one another, they then benchmark that data against
6 airports which they have identified as competing against one another. You can see that
7 from para.3.98:

8 "We now turn to the degree of substitutability between BAA's London airports.
9 When we compare the overall degree of exposure of Heathrow, Gatwick and
10 Stansted to one another with the benchmark levels provided by airport pairs that
11 we believe compete with each other ..."

12 and that was the case study material I was referring to at 3.17 to 3.21 –

13 "... we find that these exceed, often substantially, the degree to which the
14 competing airport pairs are exposed to one another."

15 Then it gives a couple of exceptions there. If one just looks at the plot, what one sees is that
16 the line furthest to the left is Manchester's exposure to Leeds Bradford airport, which are
17 seen to be competitors by the Competition Commission. Then Birmingham's exposure to
18 East Midlands airport is the purple line, which is the next left in; then Manchester's
19 exposure to Liverpool is the slightly lighter purple line. What you then see are plots for the
20 Stansted exposure to Gatwick, which is an orange line, then London Heathrow exposure to
21 Gatwick, which is the red line; the grey line, Stansted exposure to Heathrow; and then blue
22 line, Gatwick exposure to Heathrow. What is instructive about this is that in relation to
23 those first three lines where those are competitor airports actually you have less overlap at
24 significant levels of competitor district share thresholds. In fact what you are seeing is that
25 the competitor district share threshold analysis being carried out here in relation to the
26 London airports suggests that they are very close competitors because they actually have
27 greater overlap than those airports that are deemed to be competitors by reason of other
28 analysis. That is why the comparison is spelled out.

29 One economist rather elegantly put in relation to these graphs that the way that one can
30 think about them is, in a way, as strings on a lyre or a harp and the more that they are pulled
31 out the more it is that the parties referred to in relation to a particular string are effectively
32 close competitors all the way along the line. As you can see here, the strings have been
33 pulled out particularly in relation to the London airports.

1 I will not detain you further with this material, but I hope that explains both how it works
2 and why it is so significant to what was being undertaken here in relation to these matters.
3 If we then turn on through section 3 to p.79, we then reach the point dealing with passenger
4 survey evidence which Mr. Green referred to yesterday. This survey evidence obviously
5 indicates the closeness of substitutability between Heathrow, Gatwick and Stansted, and
6 was considered in some detail here. The conclusion is 3.116.

7 Then you have got the airline evidence that he also referred to at 3.117. Undoubtedly, that
8 is a rather ambiguous picture that comes out of that airline evidence, but clearly the CC was
9 looking through this in relation to a number of matters, but the key conclusions are 3.122
10 and 3.123 for these purposes.

11 Then, just above 3.124, you have “Assessment of airline switching between BAA airports in
12 the South-East and neighbouring airports”. I am very happy to go through this in more
13 detail, but I am not sure that it is core to the overall analysis.

14 Then you reach a section just over the page on “Special characteristics of Heathrow”, so the
15 effect of it being a hub airport is being specifically considered.

16 Then at 3.134 you reach the conclusions to which the Tribunal was referred yesterday on
17 demand substitutability between the south-east airports. These were the paragraphs that I
18 wrongly referred to the Tribunal because I misunderstood what the Tribunal was asking for.
19 You can see at 3.134(a) the key analysis is the catchment area analysis, on which I have just
20 given the Tribunal an indication as to how it works.

21 Then (b) indicates that BAA’s three London airports are very much the closest substitutes
22 for one another. Mr. Green says, “Oh, well, they are the closest but there are not very
23 close”. That is just not borne out that catchment area analysis at all.

24 Then you have got (c) in relation to the survey evidence, to which Mr. Green referred you.
25 At (d) airlines and main competitors are operating from other BAA which the CC considers
26 is supportive.

27 Then (e) is the Heathrow; and then (f) and (g) are really in relation to Southampton.

28 THE CHAIRMAN: One point Mr. Green did place some weight on was the reference to
29 relatively low passenger sensitivity to fare increases, which one sees in the conclusion at
30 3.134(c). I think that is reflective of ----

31 MR. BEARD: That is the BAA/CAA survey evidence, which is from 3.111 to 3.116. I am not
32 going to mess around and try and gloss over any of this evidence. The CC looked at it. It
33 did get material there suggesting that there seemed to be some degree of low price
34 sensitivity in relation to £5 and £10 price increases. Obviously the extent to which the CC

1 places weight on that material when it has carried out all of the other evidence is something
2 that the CC has done, and what the CC found was, actually, they were close competitors
3 notwithstanding that, and it does not make a conclusion anywhere that airline passengers,
4 unlike any other purchasers of any other service are somehow just going to ignore price
5 changes, and indeed they take in relation to particular price competition that as a relevant
6 factor. So they do not accept that in the overall analysis.

7 More particularly, they are exploring these matters, they are recognising the data that they
8 are receiving. They are recognising the problems with the data. What one sees in relation
9 to that analysis is the concerns about the limitations of it. Also, it is worth bearing in mind
10 what that analysis was there to do. It was not there focusing on the extent of price
11 sensitivity *per se*, it was just looking at what the next alternatives were. The problem with
12 price sensitivity analysis in surveys is because if you start asking people a series of
13 hypothetical questions about how they are going to spend their money in relation to
14 reactions in particular pricing, you do end up with certain difficulties. So it is the
15 competitive degree. It is what will you take next that is the priority, not the absolute level
16 of sensitivity to price which that data is concerned about. Therefore, you can see why the
17 CC did not fixate on that and then analysis matters.

18 THE CHAIRMAN: Yes. Would that be a convenient moment?

19 MR. BEARD: Yes, I would just direct the Tribunal to the conclusions at 3.168.

20 THE CHAIRMAN: Yes, very well. We will resume at 1.50.

21 (Adjourned for a short time)

22 THE CHAIRMAN: Mr. Beard, just before we resume may I mention one request? For the
23 purposes of writing the judgment it would be very helpful, if it is possible, to have the 2009
24 report, the 2011 report in Word document format sent through to my clerk; if it is not
25 possible, so be it, but that would make life easier. Also, Appendix A to the 2011 report,
26 Appendix 5.1 and Appendix 10.

27 MR. BEARD: Those are noted. We will double check, but I imagine there will be no problem.
28 Certainly the versions available on the website I know are copyable in any event, but they
29 do not use Word format, I think they are probably PDF.

30 THE CHAIRMAN: All right, it may be if necessary I can take chunks from that.

31 MR. BEARD: Those behind me have noted it and we will do our best to sort it out in the right
32 format.

33 THE CHAIRMAN: Thank you.

1 MR. BEARD: I was dealing just before the short adjournment with the second criticism which is
2 essentially the one that said that Gatwick has been divested so there is no incremental
3 benefit from divesting Stansted. I have taken the Tribunal through parts of section 10 of the
4 report, and section 3 dealing with why it is that in fact they are very close competitors –
5 Stansted and Heathrow being close competitors as well as Stansted and Gatwick.
6 One other point raised in passing was the notion of trilateral competition. Obviously
7 trilateral competition can have two meanings, one is that each of the three parties is
8 competing against one another and to some extent the material I have already taken you
9 through deals with that. The other way in which it can work is indirect competition, so
10 Stansted has put the pressure on Gatwick, Gatwick puts pressure on Heathrow and therefore
11 Stansted is indirectly putting pressure on Heathrow.

12 I have not taken the Tribunal at any length, or indeed at all, although you have been taken to
13 Appendix 10.1 to the report, but if I could just highlight a couple of paragraphs in that
14 Appendix 10.1. Mr. Green took you to various of these paragraphs, the Tribunal is familiar
15 with this appendix. Effectively it is laying some of the groundwork for some of the parts of
16 the report I have already referred you to, so I am not going to duplicate that. In relation to
17 this issue of trilateral competition there is a point at para.14 which Mr. Allan picked up
18 during the course of Mr. Green’s submissions, where considering the framework for
19 assessing the impact of divestitures BAA (as set out in para.13) said

20 “We should employ the following framework:

- 21 (a) establish the impact on competition of the divestiture of one of BAA’s
22 London airports.
23 (b) establish whether continued common ownership of the remaining two
24 airports would be a feature giving rise to an AEC and, if it would,
25 whether divestiture would be a proportionate remedy to that AEC.”

26 And as we have seen at 10.46 that was identified in terms.

27 “(c) establish whether regulatory or behavioural remedies would be an
28 effective remedy either in their own right or in combination with the
29 divestiture of one airport.”

30 That is what the CC does, but it approaches it with that caveat that Mr. Allan identified in
31 relation to para.14:

32 “We accept the framework proposed by BAA subject to the following caveat. In
33 applying it, we must allow for the possibility that the impact on competition of the
34 divestiture of one airport (e.g. Gatwick) may be affected by whether or not a

1 second airport (e.g. Stansted) is also divested. This is because a second divestiture
2 will change the behaviour of all the London airports with pro-competitive
3 outcomes, not just that of the two airports whose structural link has been severed.
4 For example, by increasing the competitive constraints on both Heathrow and
5 Stansted, the structural separation of Heathrow and Stansted would also increase
6 the competitive constraints faced by an independent Gatwick and therefore how
7 aggressively it competes. In the case of the London airports, this effect is likely to
8 be magnified by its knock-on effect on the need for regulation. If the divestiture
9 of Stansted were to increase rivalry between all the airports (and we believe it
10 would), then this would make it more likely that price control regulation could be
11 removed at Gatwick, increasing the effectiveness of the Gatwick remedy. We take
12 this into account when considering the impact of the divestiture of the second
13 airport.”

14 So that is effectively the first sort of trilateral competition consideration, and you have been
15 taken to various parts of the next section where Mr. Green said this is all really about
16 competition predicated on new runways, and I will not repeat the general points that have
17 been made in relation to that.

18 The paragraph I would direct the Tribunal to is para.44. This is in the course of a general
19 discussion about the dynamics of competition, but this is actually the other sort of trilateral
20 indirect competition:

21 “Given that Heathrow is the closest substitute to Gatwick and that Gatwick is the
22 closest substitute to Stansted, it seems likely that anything which induces switching
23 from Gatwick to Heathrow will also have a knock-on effect on Stansted. In other
24 words, even if there were no direct substitutability between Heathrow and
25 Stansted, which we would dispute, user substitutability between Heathrow and
26 Gatwick and between Gatwick and Stansted would, in principle, expose Heathrow
27 and Stansted to each other’s decisions in relation to capacity, price and service
28 quality.”

29 It is not really surprising given the way I have indicated the CC was approaching this by
30 looking at all sorts of dynamics of competition. It does place weight on trilateral
31 competition and it places weight on two ways in which trilateral competition may work. I
32 was not intending to take the Tribunal through any further matters in relation to those
33 issues, it is just worth echoing in para.26 in this appendix it says in terms:

1 “It is difficult to identify all the other ways in which airports which have never
2 competed before will compete. Nevertheless, it seems likely that the operator of
3 Gatwick would compete with both Stansted and Heathrow in this period ...”

4 - this is the period up to any more runway becoming available:

5 “... to retain or win particularly valuable users such as airlines which convey
6 higher numbers of passengers per ATM or passengers that contribute
7 proportionately more to retail revenues. This could take the form of tariff
8 discounts or airline-specific improvements to quality. There may also be scope for
9 separate ownership to stimulate improvements in the overall quality of service
10 offered, even at price-capped capacity-constrained airports. As we have noted,
11 airlines operating from different BAA London airports compete with each other
12 and we would expect separately-owned airports to be more responsive to airline
13 views than BAA, as a common owner, has been. We consider that good service
14 quality is often a matter of good management and organisation rather than the
15 result of spending large amounts of money (this is relevant as even separately-
16 owned price-capped airports do not necessarily have the incentives to spend on
17 improving service quality, except to achieve SQR targets).”

18 The debate I will leave, it plainly does not mean that there are not incentives to spend
19 money to invest and compete to achieve higher levels of service quality where you are
20 dealing with a competitive market.

21 “Rivalry in the provision of service quality would supplement the effect of SQR
22 targets, which are inevitably imperfect substitutes for competition. However, this
23 rivalry would not replace SQRs, at least not in the short term.”

24 The second criticism about some sort of error on the part of the CC in considering an
25 incremental impact of Stansted is just misconceived, in 2009 it was carefully considered, it
26 was assessed in 2011, it is perfectly sensibly assessed, there is no doubt that the
27 Competition Commission correctly directed itself and reached an appraisal about those
28 matters that is clearly within a sensible margin of any appreciation.

29 The third criticism that was levelled by Mr. Green was that regulation was really enough
30 and so you did not need divestment in 2011. BAA has frequently referred to “effective or
31 improved regulation obviating the need for this remedy.” The CC clearly does not share
32 BAA’s view, on the contrary, as the Tribunal has referred to in the course of certain
33 comments the CC would approve the view and stands by the view expressed in the report
34 that competition goes further than regulation. A competitive environment is a very, very

1 different dynamic to a regulated one. In particular references to the Q5 review (the
2 quinquennial review) and the CAA price control does not ensure that the effects of
3 competition have been properly felt in the market, but what is quite remarkable about Mr.
4 Green's submissions in this regard is that as I indicated by reference to the conclusions in
5 relation to section 8 and section 9 these were matters that were actually considered by the
6 CC in the course of the investigation. If you would not mind taking the report at section 6,
7 what you have is a section entitled: "The regulatory system" and this was the CC thinking
8 about the system of regulation that exists in some detail and considering how that impacted
9 on its assessment of the market, on its assessment on the constraints on competition given
10 the overlaps that have been identified, in particular in section 3.

11 In 6.1 it sets out what it is doing, it is saying "we are concerned only with economic
12 regulation, we are not dealing with safety and air traffic control here". Then it goes on at
13 6.5:

14 "We consider in this section:

- 15 (a) the legal, institutional and organisational structure of regulation;
- 16 (b) the current system of regulation of the three designated BAA London airports,
17 for which the maximum level of airport charges are regulated by the CAA;
- 18 (c) the operation of the regulatory system;
- 19 (d) our assessment of the regulatory system;
- 20 (e) the features of regulation giving rise, in our view, to an AEC;
- 21 (f) the interrelationship between regulation and common ownership of the
22 London area airports..."

23 And then there is a rather specific issue to do with traffic distribution rules. So if you want
24 an introduction as to how the regulatory scheme works and the role of the CAA, it is
25 actually set out in 6.6 onwards.

26 The key part that I would direct you to, if I may, is at 6.17: "Current system of regulation of
27 the three designated BAA London airports".

28 "As BAA's three London airports are currently designated for price regulation, the
29 CAA is required to regulate the maximum level of airport charges at those airports.
30 In common with practice in other UK price regulated sectors, the price cap is set so
31 as to provide a reasonable return on the RAB ..."

32 - which has been discussed.

33 THE CHAIRMAN: Just remind me what it means.

34 MR. BEARD: Regulatory Asset Base.

1 THE CHAIRMAN: Yes, thank you.

2 MR. BEARD:

3 “- in particular, to allow new investment to earn the cost of capital necessary for
4 such investment to be carried out – after allowing for regulatory depreciation, an
5 appropriate level of operating costs and income other than airport charges. Under
6 this system, the overall returns that an airport operator is allowed to earn are
7 determined by the size of the RAB. Thus, the operator of an airport with
8 significant market power, whose rate of return is being constrained below the
9 unregulated level in this way, will look to increase the level of overall returns by
10 expanding its operating assets beyond the unregulated level provided the rate of
11 return allowed on the RAB exceeds its cost of capital. This effect on investment
12 incentives can be beneficial, given that it mitigates the incentive that an airport
13 with significant market power would have, in the absence of regulation, to restrict
14 capacity in order to raise prices.”

15 In other words it is saying that when you are RAB regulated you will want to develop your
16 capital asset base, you have an incentive to do so because you will earn a rate of return on it
17 and therefore your profitability will effectively be higher. 6.18 is important:

18 “However, the bias towards increased use of capital created by a RAB-based price
19 regulation may have the undesirable effect of encouraging inefficient investment
20 by the company. It may also provide incentives for strategic behaviour by the
21 airport operator to inflate the size of the RAB and may discourage the application
22 of charging structures that make efficient use of capital. Whilst these are well
23 understood detriments against which regulators should be expected to be on their
24 guard they nonetheless lead to a number of general criticisms of RAB-based price
25 cap regimes:

- 26 (a) Price caps set on the basis of allowing a given return on a RAB provide no
27 strong incentive for efficient and effective investment to reflect and respond to
28 customer requirements as, in the longer term, the airport operator earns the
29 cost of capital on all its investments that are allowed regardless of how closely
30 they reflect the needs of the airlines and passengers ...
- 31 (b) As a consequence ... decisions on investment projects are made on
32 administrative, rather than market-generated, grounds, with criticisms of the
33 resulting quantity, quality, location and timing of investment.

1 (c) For similar reasons, price controls may dull the incentive for BAA to innovate
2 and to rapidly take up new technology developed by others.”

3 These are severe criticisms of a RAB-based system more generally. Essentially, what is
4 being said is that if you are RAB regulated in this way you turn away from your customers
5 and you focus your interest on the regulator, because what you are most concerned about is
6 getting clearance for any capital expenditure to be included in the RAB. If you do that, you
7 will earn your return on capital, you will be a profitable business. The concern of the
8 regulator, therefore, is constantly to be putting pressure on someone to turn the other way
9 and face customers and deal with customer needs and this creates a significant problem,
10 because essentially you get a situation which has been identified here where the regulatory
11 structure is meaning that the entity regulated is facing the wrong way and is not engaging
12 with customers as competition would want it to be. This is developed in 6.20, the general
13 criticisms of an RPI-X RAB-based price cap. RPI-X is just Retail Price Index minus X per
14 cent, which is a mechanism for changing the return on the regulatory asset base in order to
15 try and incentivise efficiencies through the regulatory process, but these are a range of
16 criticisms. The one I have highlighted, because it anticipates what I am going to say a little
17 later on on service quality, 6.20(d):

18 “Price caps may also provide insufficient incentives to improve the quality of
19 service.”

20 I just invite the Tribunal to read that paragraph.

21 THE CHAIRMAN: Yes. (After a pause): Yes.

22 MR. BEARD: This section of the report and engages in a very detailed discussion about the
23 problems of regulation and I am not going to take the Tribunal through it; the point is that it
24 exists, and concerns are being expressed all the way through about the adequacy of the
25 regulatory system given these fundamental problems with it. At 6.29 there is the heading
26 “The operation of the regulatory system”, so it is specifically focused on what has been
27 going on with the price control regimes, with the operation of the Q1, 2, 3, 4 and 5 reviews,
28 and so forth.

29 Over the page you will see there is a section headed: “Assessment of system of regulation”
30 at 6.38 which details a number of criticisms – again I just highlight 6.38(d) where there is
31 specific concern being expressed about SQRs in particular. I am not sure it adds a great
32 deal to the paragraph to which I have already referred you, it is just a matter for noting.

1 Then one turns on through this section. As I say, it is quite a lengthy exposition of these
2 issues, and then it highlights in 6.60 that actually it has concerns that the regulatory system
3 does have an adverse effect on competition and there should be changes to it.

4 So what the CC is doing is looking both at the regulatory system and at the arrangements in
5 place and saying: "Look, you need divestiture and you need a new regulatory system, and
6 this will help create competition". So for Mr. Green to be saying that you do not need to
7 have divestiture and in fact regulation is fine, is plainly wrong, it is not what the CC said,
8 and it had explored these issues. It then goes on and deals with issues about common
9 ownership and regulation, some of which briefly Mr. Green took you to, but he did so in the
10 context of certain cross-references to which I will come and sought to ignore various
11 sections in here where there were comparative analyses for instance of the electricity and
12 gas markets' regime that are discussed in 6.74 and 6.75. That is just wrong, you cannot
13 ignore this sort of analysis, it is all part of the general picture that the CC is building up.
14 There are one or two passages there, and since we are in 6, and perhaps to save coming back
15 to it, I just point to 6.82

16 THE CHAIRMAN: Shall we read that?

17 MR. BEARD: Yes, if you would not mind. It is in anticipation of some submissions to be made
18 on capex and opex.

19 THE CHAIRMAN: Right. (After a pause): Yes.

20 MR. BEARD: The conclusion at 6.4 was separate ownership; we have the further benefit of
21 allowing actual and potential investors to compare company and management, and
22 operating performance. I also highlight that simply because it goes to how the dynamics of
23 competition are going to work.

24 That then deals with the suggestion that somehow regulation is a panacea, or at least a
25 sufficient protection, that you did not need to order a divestment of Stansted, it was clearly a
26 matter considered carefully by the Commission in the context of its overall findings borne
27 in mind when the remedy decision was taken.

28 That then takes me to the fourth of Mr. Green's criticisms, which is the collection of
29 specific criticisms of the particular heads of the proportionality analysis in the 2011
30 decision. I will try and refer and stick with the 2011 decision insofar as possible, so it is at
31 tab 2 of bundle A, and if you could turn to para.280. All the specific criticisms are, of
32 course, levelled at the proportionality exercise conducted under what is effectively limb D
33 of the *Tesco/Fedesa* proportionality test, does the remedy produce adverse effects which are
34 disproportionate to the aim pursued?

1 In this section, there is a brief setting out of the overall conclusions on proportionality.

2 “We have considered whether it is proportionate to require the divestment of
3 Stansted in light of the change in government policy ... For the purposes of this
4 assessment, we take account of the reduced likelihood of benefits of the remedy
5 package accruing that relate to the development of new runway capacity or
6 competition based upon new runway capacity.”

7 So that is the anticipatory competition. The analysis is set out in Appendix A, which I will
8 come on to.

9 “We have looked at the costs of divesting Stansted. BAA provided three estimates
10 of divestment costs ...”

11 and they are set out there.

12 “For the reasons set out in Appendix A, we conclude that BAA’s ‘low’ estimate of
13 £36.1 million is the upper end of what we expected the net relevant costs of the
14 Stansted divestiture to be.”

15 Then at 282:

16 “We have considered the benefits of divesting Stansted. As in the 2009 report, we
17 consider the benefits from competition are likely to accrue across all of Stansted,
18 Gatwick and Heathrow as a result of intensifying rivalry following divestiture of
19 Stansted.”

20 And then:

21 “For the reasons set out in Appendix A, we concluded ... that there are many
22 sources of long-term benefit Service quality, capital cost efficiency savings,
23 operating costs...”

24 - and so on. Just on 283:

25 “In Appendix A, paragraph 78, we conclude that we would still regard the benefits
26 of divestment as likely substantially to outweigh the costs of divestiture even if
27 those costs were as high as BAA’s maximum suggested divestiture cost of £42.5
28 million, a figure which, for the reasons set out in Appendix A, appears to us to be a
29 substantial overestimate.”

30 I highlight those paragraphs, but then if we could turn to Appendix A itself. As I say, I am
31 going to focus on the criticisms that are made of the assessment of benefits that are the
32 foundation of Mr. Green’s ground 1. But, before doing that and in anticipation of one or
33 two points in relation to ground 4, it is just worth turning the pages on Appendix A because

1 it starts off with “Expected relevant costs of Stansted divestiture”, and it refers to the
2 estimates used in the 2009 report.

3 “Appendix 10.3 of the 2009 report examined the costs and possible loss of
4 benefits of common ownership resulting from a divestiture remedy. The appendix
5 contained an assessment of three categories of relevant costs of divestiture that
6 BAA identified, namely: (a) loss of economies of scale; (b) loss of unquantified
7 benefits of common ownership; and (c) separation costs.”

8 It says in 2009 the assessment was made in Appendix 10.3 that:

9 “... the economies of scale that BAA identified ... 'we consider it unlikely there
10 will be significant relevant customer benefits arising from [such] economies of
11 scale'.”

12 Then in relation to the unquantified benefits of common ownership again it did not see that
13 there would be any significant benefits. Then it focused on the separation costs.

14 The point I want to make is that Mr. Green has repeatedly said: “Oh, well, the CC only
15 focused on the specific and direct separation costs”. Actually, what the CC did both in 2009
16 and in 2011, was looked at what BAA put forward in terms of costs and detriments of
17 divestiture and essentially in relation to economies of scale, what BAA is saying is: “We
18 run a business better when we have two or three airports altogether because we get all sorts
19 of economies of scale, whether it is IT, contracting, procurement, etc and obviously we will
20 be losing those if you require us to divest and that is a detriment that should be weighed in
21 the proportionality balance.” The CC looked at it in 2009 and it looks again at it in 2011
22 when this point is repeated and said there is nothing to see here of any materiality. There is
23 no challenge to that finding at all, but the point is a simple one. It was not that the CC was
24 blinkered in the way it looked at cost and detriment, it listened to what BAA had to say and
25 we looked at them in the round.

26 So paras.10 to 17 are considering those economies of scale arguments again, and reaching a
27 conclusion in line with the 2009 report. Paragraphs 18 and 19 are then doing the same in
28 relation to other sorts of detriment that BAA identified from the proposed divestiture, albeit
29 that in 2011 that was a common ownership detriment that was being referred to only in
30 relation to Heathrow and Stansted, whereas of course in 2009 it was Heathrow, Stansted and
31 Gatwick.

32 Then we get on to the separation costs, the direct costs of separation and here what we have
33 is a discussion of the Gatwick divestiture costs and these figures that are marked in my copy
34 in blue are all confidential, and I am not going to go through them, but what the CC did was

1 it looked at the Gatwick divestiture costs and then it made an assessment of the Stansted
2 transaction costs. If one reads all of that what one sees is the CC saying: “We are
3 extraordinarily sceptical about the level of costs you are claiming actually will be incurred
4 in relation to Stansted. But, for the purposes of this analysis we will take as the upper end
5 of the band of costs that we will consider £36.1 million” and so that was the basis on which
6 they proceeded, which is at para.40.

7 Having been through consideration of the cost and detriments, they then ask themselves the
8 question are we in territory where the benefits are likely to outweigh those costs that have
9 been put to us and that we have assessed, and that is when at para. 41 there is a
10 consideration of what the scale of the benefits that would be required is. At para.42 we get
11 a reconsideration of that per passenger measure that was referred to earlier by the Tribunal
12 in relation to both Stansted and Gatwick and the numbers have moved.

13 In part, the numbers have moved because the numbers of passengers going through Stansted
14 have fallen, and that is set out in para.42, but it is nonetheless a very small amount of
15 money that we are talking about. The benefits would only have to be between 3p and 4p
16 and 14p to 19p per passenger on average over the next 30 years at Stansted in order to
17 overcome those divestment costs that are being identified.

18 Then we come to “Duration of assessment” and I will come back to that because that is the
19 sixth of Mr. Green’s criticisms.

20 Then we turn to look at the “Benefits of divestiture” at para. 44:

21 “We look next at the customer benefits that would flow from divestiture.”

22 And here in para.46 there is the reference again to the list of factors in para.3 of Appendix
23 5.1 which originated from the CAA, and a citation in para. 45 of those general factors that
24 go to competition.

25 Then in para. 52 we get to service quality improvements, but what is important is just to
26 mention the heading: “Likely areas of benefit beginning in the near future”. Given all that
27 has been said previously about those uncertainties, this is the CC using its judgment in the
28 light of all the exercises it has undertaken, and having regard to things like the Q5 report,
29 having regard to what went on in 2009 in making these assessments. So when Mr. Green
30 says: “We have Appendix 5.1 and nothing else really here” that does not give a proper and
31 fair appraisal of the work, the understanding, the experience, and the judgment brought to
32 bear in relation to these sorts of issues. In particular I have highlighted the points made in
33 s.6 about why it is that SQRs themselves are not adequate for generating the relevant quality
34 benefits as compared to a competitive regime. But it is not just in section 6 that one sees

1 these matters, if the Tribunal could take out one again the 2009 report, and turn up section 7
2 of that report.

3 THE CHAIRMAN: Yes.

4 MR. BEARD: 7.1 and 7.2 set out what has been done in this section.

5 “We have concluded in Sections 3 to 6 that a number of features of the markets we
6 are considering – common ownership, planning, government policy and the new
7 regulatory system – prevent, restrict or distort competition.”

8 Sir, you were asking earlier about where does the AEC come from. In a way that is
9 summarising the position in Sections 3 to 6.

10 “In this section we consider the conduct and performance of the BAA airports as a
11 further indication of:

- 12 (a) the extent of competition they face:
13 (b) the possible effects of the AECs of common ownership and the other features
14 identified above, including in the case of London airports, the effects of
15 economic regulation; and
16 (c) the effects of the features we have identified on competition in other
17 markets...”

18 Then at 7.2:

19 “The main aspects of conduct and performance we consider are:

- 20 (a) capital expenditure ...
21 (b) service standards;
22 (c) route development;
23 (d) financial performance;
24 (e) efficiency; and
25 (f) financing.”

26 If you turn on to 7.87 I just ask the Tribunal to read 7.87 and 7.88.

27 THE CHAIRMAN: (After a pause): Yes.

28 MR. BEARD: So the CC is engaging directly with these service quality issues, looking at the
29 reports that come back. If you go on to 7.93: “The SQR scheme at Heathrow and Gatwick”

30 “In our 2002 Q4 report we found that HAL and GAL had pursued a course of
31 conduct contrary to the public interest by failing to make prices paid sufficiently
32 reflect the level of service provided. Following that report, and to remedy the
33 adverse effect identified ...”

34 So just focusing on what had been identified in that report:

1 “... the CAA introduced an SQR scheme which required payment of rebates to
2 airlines if particular service standards were not met.”

3 7.94:

4 “Despite the operation of the SQR scheme, during our Heathrow/Gatwick Q5
5 inquiry we received strong criticisms of aspects of quality of service, especially at
6 Heathrow and in relation to central security queuing and some activities not
7 currently included in the scheme.”

8 Then it notes some comments from the OFT, and then it goes through and considers various
9 of the points that had been raised about the SQR scheme, and then it discusses that in
10 relation to CAA revisions of it. So it was thinking about this SQR scheme that had actually
11 been in place for some time at Heathrow and Gatwick.

12 Then 7.99:

13 “In our Stansted Q5 report, we examined BAA’s performance ...”

14 So this is just dealing with Stansted, as Mr. Green said yesterday the SQRs only came in
15 after that in relation to Stansted, so there was not a test bed for them. Then at 7.100 the
16 Competition Commission is recognising that actually performance had improved in 2008,
17 so it had given very detailed consideration to these SQR issues ----

18 THE CHAIRMAN: Sorry, that is better quality of service where?

19 MR. BEARD: That will be:

20 “BAA quoted evidence of much better quality of service for 2008, as is also to
21 some extent shown in Table 7.3.”

22 If you go back to 7.3 ----

23 THE CHAIRMAN: In fact, looking through the rest of that paragraph they seem to be talking
24 about all three airports?

25 MR. BEARD: Yes, I think they are talking about all three airports; 7.3 does actually talk about
26 all three and, indeed, the Scottish airports. The point I am making is simply the CC has
27 carefully considered how these SQRs work, the history of their operation and it recognises
28 there had been some upturn in performance, in relation to meeting those SQRs particularly.
29 Now, obviously in relation to Stansted it is different, and table 7.3 is more general ranking.
30 It is not a glorious improvement – Stansted has moved, I think, from 99th to 82nd out of the
31 101 airports, but nevertheless ----

32 THE CHAIRMAN: Sorry, which table are you now looking at?

33 MR. BEARD: I am sorry, all I ----

34 THE CHAIRMAN: 7.3, I cannot find it.

1 MR. BEARD: If you go back to para.7.87 it is at the bottom of that page, Sir.

2 THE CHAIRMAN: I do not think that is SQR specifically.

3 MR. BEARD: No, it cannot be SQR because it has Stansted in.

4 THE CHAIRMAN: That seems to be some general quality assessment by contrast with table 7.4
5 which is SQR targets missed.

6 MR. BEARD: That is quite right, I am sorry. The point I was making here was there was
7 recognised to be a general performance increase by reference to those table 7.3 rankings,
8 and in relation to SQR performance, that is entirely acceptable at the CC.

9 THE CHAIRMAN: Where do we get the improved performance by reference to SQR?

10 MR. BEARD: If you go on to 7.101, I think?

11 THE CHAIRMAN: I do not get a clear comparison with previous periods in 7.101.

12 MR. BEARD: I am sorry, no. I am trying not to be uncharitable to BAA in its submissions about
13 SQR. The reference there is that “performance at three Heathrow terminals was poor in
14 April with over a third of SQR targets missed but has since improved somewhat.” And I do
15 not want it to be said that I am trying to oversell these issues.

16 THE CHAIRMAN: That text and table does not go back to the earlier period?

17 MR. BEARD: No.

18 THE CHAIRMAN: SQRs had been in operation for the period before, had they not?

19 MR. BEARD: It is not precisely set out here, but they were put in place following the 2002 Q4
20 report, so they had been in place for a while, which is why you get the discussion of the
21 SQR scheme at Heathrow and Gatwick in some detail there.

22 THE CHAIRMAN: All right.

23 MR. BEARD: But when you get to 7.102: “BAA has, moreover, responded to its quality of
24 service problems by a substantial increase in costs, only partly offset by improvements in
25 efficiency.” So the CC is recognising there are changes, and there are some improvements,
26 but they come at a cost as well. The only point I am making in relation to these matters is
27 that when it is said that actually there has not been consideration of service quality issues,
28 actually there has been substantial consideration of service quality issues that led to the
29 terms of Appendix 5.1 para.19. But, in 2011 what the CC has is the most valuable sort of
30 information, it has the natural experiment at Gatwick and that is what is then dealt with at
31 para.53 through to 57, because what you have there ----

32 THE CHAIRMAN: Of what?

33 MR. BEARD: I am sorry, I have moved back to Appendix A to the 2011 decision, I am sorry.

34 THE CHAIRMAN: And the paragraph numbers again?

1 MR. BEARD: “Service quality improvements” start at 52, submissions I have just been making
2 relate to 52 in para.19 from Appendix 5.1, which is quoted there, and then 53 through to 57
3 are talking about the consideration of the natural experiment at Gatwick.

4 THE CHAIRMAN: Yes, thank you.

5 MR. BEARD: What you see there is citation of how Gatwick, in separate ownership, had
6 radically improved its service quality. At 55 there is a consideration of updated SQR
7 statistics, but what is being referred to there is how, under common ownership, you can get
8 a whole range of other benefits of service quality. Just for your notes, the evidence from
9 Gatwick in relation to those matters is set out in particular at para. 53 of the main text of the
10 2011 decision, that is referred to at 53. The CAA’s appraisal of that is at 58 of the main
11 text, and that is referred to in para.56.

12 So contrary to what Mr. Green was saying, actually there is a very substantial consideration
13 and evidential base for what the CC is saying here about the scope for service quality
14 benefits where you free up competition. So the idea that this is all marginal, peripheral,
15 tenuous and conjured from thin air by the CC is just wrong. It was considered carefully in
16 2009, it was analysed, I have referred you to section 6, section 7, and it is worth noting for
17 your notes Appendix 10.1 of the 2009 report, where there is a specific reference to the
18 substitutability analysis indicating that competitive initiatives at Heathrow, such as capacity
19 expansions or improvements in service quality would have an effect on passenger numbers,
20 airline performance and ultimately airport performance at Stansted. That is just an echo of
21 one of the quotes that I gave you earlier.

22 THE CHAIRMAN: Which paragraph was that?

23 MR. BEARD: I am sorry, it is para. 6 of Appendix 10.1, but it is just a matter of completeness for
24 notes.

25 THE CHAIRMAN: All right.

26 MR. BEARD: So when we take all these factors together what we see is that it was considered by
27 the CC in 2009, it was clear that the CC did not consider that the SQR scheme was adequate
28 and that the regulatory schemes had been considered in some detail in section 6 of the report
29 in particular, and so we do have a perfectly sound, evidence-based analysis that is being
30 undertaken in relation to service quality review, and we have some of the best evidence you
31 could have, the natural experiment of the common ownership of Gatwick bearing out the
32 concerns that common ownership was stymieing service quality development at BAA
33 airports.

1 In the circumstances, the idea that somehow the CC was overplaying the service quality
2 benefit potential in circumstances where there were capacity constraints is simply not one
3 that can be properly maintained.

4 If we can then move on to capital expenditure efficiency savings, that is then dealt with in
5 paras. 58 through to 67 of Appendix A, and I am conscious that the Tribunal has been taken
6 through this. Mr. Green, when he first went through it, systematically skipped over para. 62
7 but the Tribunal brought him back to it, and para.62 is of particular importance, because
8 what you see in this section of Appendix A is that the Competition Commission recognises
9 that at Stansted what has been referred to as the SG2 capital expenditure is not going to be
10 taken into account because SG2, as you recall, is related to new runway developments, we
11 can see this at para. 60. But SG1 capex and, as you will see at para.60, the estimate of the
12 long term capital expenditure plans assume investment of £20 million in forthcoming years,
13 and an average of £35 million a year for the remainder of the decade; substantial non-
14 runway related costs in any event, so those are significant.

15 When we go to para.62 it is important to recall these aspects of competition being felt at the
16 other airports, because when you talk about aspects of competition being felt at the other
17 airports you are dealing with vast amounts of non-runway related capital expenditure – huge
18 amounts. Heathrow is talking about an outturn capex unrelated to runways to 31st March
19 2014 of over £5.5 billion. Gatwick, where there is no prospect of runway capacity
20 expansion, is talking in terms of £0.75 billion. So we are looking at billions of pounds of
21 capital expenditure amongst these three airports. If the dynamics of competition that have
22 been analysed have even the most fractional impact in these circumstances, it is going to
23 vastly outweigh the cost that we are talking about of divestiture and those figures are figures
24 running up to 2014. But, of course, the CC has said: “We are looking at the benefits of
25 competition over 30 years.” I am not saying that there is going to be a new Terminal 2
26 every five years at Heathrow or anything silly like that, and of course there will be
27 fluctuations in capital expenditure. But these are very, very large sums and it simply cannot
28 be suggested that somehow the CC has taken leave of its senses in considering capital
29 expenditure matters.

30 Mr. Green said that capital expenditure is not specified in Appendix 5.1. The Tribunal
31 picked up the fact that it had actually been specified in particular in para. 10.110, but
32 actually it is necessary to go back to section 7 again just to highlight the extent to which
33 capital expenditure considerations were taken into account by the CC in the way that they
34 dealt with these things, it actually starts at 7.4.

1 THE CHAIRMAN: The 2009 report, para. 7.4 is that right?

2 MR. BEARD: I am sorry, yes, 2009, 7.4.

3 THE CHAIRMAN: Yes.

4 MR. BEARD: Here you have a discussion of the capital expenditure including relationships with
5 airline customers, which is introduced in para.7.4 to 7.6, and what the CC does, as is
6 indicated in subparagraphs (a), (b), (c), (d) and (e) is it looks at the long term record of
7 BAA in developing capacity and whether or not it has real concerns about the capital
8 expenditure that has been undertaken, and whether or not it could be dealt with more
9 efficiently.

10 When it comes on to deal with these things it considers capacity development more
11 generally, and the paragraphs I would highlight in particular are para.7.16 to 7.18, where
12 there is a starting discussion about the levels of capital expenditure which, in part, go to the
13 figures that I have just referred you to in para. 62 of the 2011 decision, Appendix A.

14 THE CHAIRMAN: Do you want us to read those paragraphs?

15 MR. BEARD: I think, given the time, perhaps those can be skated over. What I would then take
16 you on to is the comment on those. 7.21:

17 “Despite the scale of BAA’s capital expenditure programme, we received
18 considerable criticisms of BAA’s approach to capital expenditure, in particular the
19 method and timing of its consultation process, during our Q5 reviews of the
20 designated airports and as part of this inquiry.”

21 Then at 7.23 what is then explained is the way in which the consultation on capital
22 expenditure was so wholly unsatisfactory in relation to that capital expenditure programme
23 to which the Commission has been referring. It emphasises why consultation is so
24 important. It is so important because of that feature of RAB-based regulation. If you are
25 not engaging in consultation with the customers about the capital expenditure you engage in
26 then the regulatory framework incentivises that building of capital investment which is not
27 necessarily in the interests of customers. Indeed, we will no doubt hear from Ryanair about
28 the concerns they have about gold-plating, because that is a central concern about this
29 because they feel that they are not consulted ----

30 THE CHAIRMAN: We will only hear from Ryanair if they are going to say that you have missed
31 the point, so you have now made that point, I think.

32 MR. BEARD: Certainly. The point is made more generally in relation to RAB-based regulation.
33 But then what follows, 7.5, and I am not going to take you through it in detail – in the
34 following paragraphs we consider the consultation processes at Heathrow and Gatwick, the

1 consultation processes prior to 2005, after 2005, the processes at Stansted, and the role of
2 certain trigger mechanisms that are built into the regulatory regime, the expenditure
3 programmes, alternative options for funding, and so there is a very detailed account of how
4 capital expenditure has been carried out at these various airports, and just for your notes I
5 would highlight 7.46 onwards, which is concerned with consultation processes at Stansted.
6 It refers to the process of the Q5 review and emphasises just how poor that process has been
7 at Stansted. The prior sections are all about how poor it has been at Heathrow and Gatwick.

8 THE CHAIRMAN: So that section goes on to 7.53, is that right?

9 MR. BEARD: I think it might go on until 7.55 in fact.

10 THE CHAIRMAN: I just want a note of the paragraphs.

11 MR. BEARD: Yes, 7.55, and then you get onto the trigger mechanisms. I will just turn very
12 briefly to the end of this section. It ends at 7.86 when we turn to deal with service
13 standards, but the relevant conclusions are found at 7.137. It starts off:

14 “In our view at South East airports BAA currently shows a lack of responsiveness
15 to the interest of airlines and other users that we would not expect to see of a
16 business competing in a well functioning market, as evidenced in:

- 17 (a) a lack of responsiveness to interests of users on capital expenditure
18 which adversely affects the quantity, quality, location and timing of
19 investment
20 including ...”

21 and then it gives all sorts of examples that have been traversed in the prior paragraphs about
22 those concerns.

23 Then one notes 7.138:

24 “We regard the above weaknesses in BAA’s performance as further evidence that
25 the AECs between airports we have identified in Sections 3 to 5, including the
26 common ownership of the three airports and the particular position of Heathrow as
27 the UK’s main hub airport. But they also show the detrimental effects on
28 customers of those AECs, in particular, inadequate consultation with airlines,
29 capital expenditure that is inappropriate to meet user requirements, and poor
30 quality of service although this has recently improved. To some extent, the scale
31 of these adverse effects is likely to have been reduced by the system of regulation.
32 (for example, the institution of Constructive Engagement and agreements on
33 consultation, reduction in Stansted capital expenditure proposed for Q5, and the
34 SQR system), but as we have concluded in Section 6 there are weaknesses in the

1 regulatory system which fails adequately to remedy these adverse effects, which in
2 turn has AECs between airlines.”

3 Then the last sentence is actually to do with the prior point I was making about SQRs:

4 “Poor quality of service, for example,... has adversely affected competition,
5 particularly for transfer traffic, with airlines based overseas; and inappropriate
6 specification and/or cost of capital expenditure further adversely affects
7 competition between different airlines at particular airports... and competition
8 between airlines operating from different airports.”

9 So a full consideration of capital expenditure and one that then informs the way in which
10 the conclusions are made in relation to the remedial sections in Section 10 of the Report,
11 and more particularly, it informs the way in which capital expenditure savings
12 considerations are taken into account in the 2011 Decision. So it was not just a matter of
13 10.110 is a short way of summing up the point; actually there was a much more extensive
14 consideration of the way in which capital expenditure efficiencies could undoubtedly be
15 made here.

16 One notes if one goes back to Appendix A of the 2011 Decision, I have highlighted para.62
17 which talks about those very large sums of money that are engaged in the capital
18 expenditure programme which was also commented on in Section 7. Then you have got
19 para.63 which is saying in terms that regulation does not solve these problems. Then in
20 paras.65 and 66 what we get is again the reference to the natural experiment. When
21 Gatwick is put into independent ownership it changes its plans; it finds different ways of
22 delivering quality of service to customers without engaging in the vast expenditure that
23 BAA had originally budgeted for. Yes, that is about Gatwick but that is as good and as
24 clear evidence as you could possibly want in relation to these matters against the backdrop
25 of what you already had. That is capital expenditure.

26 Operating cost efficiency savings dealt with at para.68 through to 72 of Appendix A.
27 Clearly similar sorts of concerns and dynamics of competition apply in relation to those
28 matters. What you see is an identification in para.72 that the operating expenses are very
29 significant in relation to these airports, and in particular in relation to Stansted. So we are
30 talking about large sums of money.

31 Mr. Green said yes, but operating efficiency in para.10.110 has only referred to absenteeism
32 and some pay matters. Actually, those may be significant in and of themselves, but the
33 principle of benefits accruing in terms of dealing with -

34 THE CHAIRMAN: I think they are put forward in 10.110 as illustrative.

1 MR. BEARD: Yes, I think you have the point. Just for your reference for your note therefore, in
2 Section 7 of the 2009 Report there is a detailed consideration of issues relating to efficiency.
3 That is 7.125 through to 7.130. It talks about the lack of excellence in operating efficiency.
4 It is based upon various reports and consideration in Q5. Yes, it talks about absenteeism,
5 but it is perfectly legitimate, right, and indeed sensible. It would be bizarre to isolate certain
6 components of operating efficiency as being subject to competition effects and not others.
7 Then we come to the comparative competition under economic regulation. Again, it is an
8 unimpeachable conclusion that if you have the three sets of accounts, in so far as regulation
9 is required (and the Competition Commission recognises that it will be required at least in
10 the short to medium term in relation to Stansted and Gatwick and longer in relation to
11 Heathrow) having these benchmarks which enable the regulator to put pressure on the terms
12 on which it regulates are inevitably going to be of assistance to it, and the regulator says as
13 much.

14 These matters were dealt with at some length in Section 6 of the report to which I have
15 already referred the Tribunal. Mr. Green seemed to say if you did not refer to anything but
16 6.64, 6.65 and 6.72 in the Appendix A at para.73 none of the rest of it counted. With
17 respect, there is just no basis for proceeding on that basis in relation to the reading of the
18 report. The 2009 Report should be read as a whole. It is clearly relevant here. So for him
19 to say the examples drawn on in relation to Ofgem and so on do not matter, it is just not
20 open to him.

21 Unless the Tribunal wants me to take them back to Section 6 and particular relevant
22 paragraphs, the submission is there in relation to those matters. I have referred you in
23 particular to 6.64 in the Report which sets out very clearly these issues pertaining to
24 common ownership and regulation.

25 THE CHAIRMAN: I do not need more. No, we are happy.

26 MR. BEARD: That takes us on finally to price competition of the particular issues. The
27 Competition Commission has always said because of the capacity constraints those benefits
28 would be modest. It is not clear that there is any real contention that you could not have
29 price competition. Plainly you can, and we recognised that given those capacity constraints
30 it would be more limited. But what is instructive is to look at what is said in relation to the
31 quantum of that at para.75 Appendix A 2011. We have been through many of the reasons
32 why that is going to be a factor. The Competition Commission recognises, because of
33 capacity constraints in place, it will be more modest than would otherwise be the case. If
34 you look at para.75 and look at the forecast aeronautical revenues, based on the passenger

1 estimates and then look at the level of reduction in price that would be required - if you
2 remember we are talking about that 3p to 4p versus up to 17p to 19p depending on a range
3 of sensitivities.

4 If you look at that as a percentage of the per passenger income it is extremely modest. That
5 is price competition alone outweighing the levels of cost that have been identified.

6 THE CHAIRMAN: Just on that, what would be your submission if the picture that one got from
7 the analysis was that the Competition Commission accept that the costs of divestment
8 would be £36.1 million and that, let us say, the reduction in prices (which was the only
9 effect which one could identify) was £36.2 million?

10 MR. BEARD: It does not make a material difference in those circumstances.

11 THE CHAIRMAN: Mr. Green submits that that would not be good enough to make divestiture
12 proportionate.

13 MR. BEARD: No, it is perhaps necessary to take it in stages. The first point is that these are
14 likely benefits that have been identified and in relation to a number of them there is a sense
15 of the broad quantum that you are talking about.

16 THE CHAIRMAN: Let us not get hung up on whether what I have said is an accurate picture. I
17 was not suggesting it was. I just wanted your submission on the point of principle.

18 MR. BEARD: Understood. The difficulty is if you have got a situation where the Tribunal says
19 perhaps the Competition Commission has over-egged some of these factors then we say that
20 does not make any difference because we were carrying out a broad judgment in the round
21 and we were not trying to attribute one particular level to one or another. That is why we
22 did do the cumulative assessment.

23 If you are saying some of these are non-existent, so on your hypothesis, the first four are
24 non-existent --

25 THE CHAIRMAN: That was not really the point I was trying to test. It is that if there is only a
26 very slight identification of public benefit from requiring divestiture as against the cost to
27 BAA of divestiture, do you say as long as there is some benefit, however small, as long as it
28 is not *de minimis*, is that sufficient or on a proportionality test does there need to be
29 something more substantial?

30 MR. BEARD: I think it is necessary to take this proportionality test as a whole. What are we
31 doing here? We are remedying an AEC. We are asking ourselves should we vary from the
32 remedies that were being put in place in 2009, because that is the s.138(3) test. If you come
33 to a conclusion that actually the benefits are just above the cost, it does not give you a
34 reason to reverse the remedies that have been put in place in those circumstances. That is

1 the statutory scheme that we are dealing with. So it is not clear how Mr. Green could ever
2 get home in relation to that.

3 Furthermore, it is a bold submission by Mr. Green in any event, because each of those heads
4 does potentially exist. The Competition Commission has avoided sometimes a spurious
5 degree of precision by attaching one value to one and one to another. It has looked at them
6 in the round because of the uncertainties. It is a qualitative assessment, as it says at the
7 outset of the proportionality assessment. As it has gone through it has actually looked at the
8 extent to which the sort of figures we are talking about mean that the costs involved would
9 be outweighed. So when you are talking, for instance, about capital expenditure, it has
10 taken the time to look at what sort of capital expenditure we are talking about, and what sort
11 of levels of change would be required and it is saying that they are tiny. In those
12 circumstances, only the tiniest incremental benefits from competition and divesting Stansted
13 would clearly be a substantial benefit to customers and consumers in those circumstances.

14 THE CHAIRMAN: Thank you.

15 MR. BEARD: There is one other point that is worth bearing in mind here. Actually, a
16 conservative approach has been taken throughout. It is conservative in relation to the level
17 of costs attributable because it took BAA's range that had been progressively inflated.

18 THE CHAIRMAN: Sorry, but it took the lower end of that.

19 MR. BEARD: It took the lower end of that, but it does not think that BAA's range was right in
20 any event. It has also said in para.42 of the main body of the Decision that the costs in
21 question are such that even if you took the top end they would be outweighed in any event.

22 THE CHAIRMAN: But what indicators in the report are there that the Commission deliberately
23 took a conservative approach?

24 MR. BEARD: I am sorry, maybe I went through this too fast, but the section that deals with this
25 is in Appendix A. It is the section that deals with the proposed costs that were put forward
26 by BAA in relation to Stansted which start at para.20.

27 THE CHAIRMAN: Is there some paragraph where they say we have deliberately taken a
28 conservative approach?

29 MR. BEARD: Paragraph 39 says:

30 "In our view, BAA's 'low' estimate is likely to overestimate the separation costs,
31 bearing in mind, for example, the learning gained from the divestiture of Gatwick
32 and the changes to BAA's IT infrastructure made since 2009, which have moved
33 Stansted closer to being a stand-alone business for IT purposes. However, whilst

1 we believe they are an overestimate, for the purposes of comparing the costs
2 against the benefits, we use [that].”

3 THE CHAIRMAN: Right.

4 MR. BEARD: The preceding text is making that good. There are two other elements in which it
5 is conservative, of course. One is (as we will deal with in relation to ground two) the
6 additional spare capacity that is referred to at airport that has arisen since 2009. That is not
7 taken into account at all. It is also worth bearing in mind that the prospect of new runway
8 capacity is also entirely left to one side. So there is a sort of conservatism about the general
9 way in which the Competition Commission has gone about its task in relation to these
10 matters. I will come back to that briefly in relation to ground two.

11 Just to finish off on duration, because there is really not an awful lot to be said about
12 duration, the articulation of why a 30 year time period is an appropriate one over which to
13 consider the benefits is eminently sensible. In 2011 Decision Appendix A para.43 the
14 considerations are there well set out. It was the approach adopted in 2009. There was no
15 good reason to depart from it on the basis of the points that had been put forward in the
16 course of the MCC consultation. Unless I can assist further on the duration of benefits,
17 those are my submissions. That means that the four sets of criticisms that have been
18 levelled at the Competition Commission in relation to its proportionality exercise simply
19 have no merit whatsoever.

20 Then, could we just deal very quickly in relation to ground two. I leave aside the question
21 whether or not there really is a challenge to an AEC. We note the headline in the Notice of
22 Application but it is not dealt with in the speaking note; it is not dealt with in the skeleton.
23 It really makes no matter because it is just a bizarre ground of challenge.

24 In paragraph 111 of the 2011 Decision the Competition Commission reasons could not be
25 clearer.

26 THE CHAIRMAN: Forgive me, ground two?

27 MR. BEARD: Ground two is the fact that the Competition Commission was taking into account
28 additional spare capacity at Stansted when it fed it in.

29 THE CHAIRMAN: Right, yes. Sorry, I just noted that is just a bizarre ground and you went on.

30 MR. BEARD: I will make that good. Paragraph 111 of the 2011 Decision, you have already
31 gone to this. I think the Tribunal already has the point, but just for completeness.

32 THE CHAIRMAN: Let me just see what the point was, because I cannot remember. This is what
33 is said to be the conflict between para.111 and then was it 285 conflicts with para.114. That
34 is the point?

1 MR. BEARD: Yes, that is the point. I am not quite sure how much elaboration it requires. It is
2 plain that in 111 the Competition Commission is saying: we are not taking into account in
3 the proportionality analysis the potential benefits of the additional spare capacity that has
4 arisen at Stansted since 2009. BAA in its submissions had objected to that. As a matter of
5 conservatism the Commission said: OK, we are not going to do that; we do not need to and
6 left it. They said that in 111.

7 At 285, as the Tribunal observed when taken to these passages by Mr. Green, it is dealing
8 with a situation where at 284 a conclusion has been reached that the divestment is plainly
9 proportionate. Then at 285 it says:

10 “This conclusion is based on an assessment of the benefits that may be expected to
11 accrue starting in the near future and continuing over 30 years. In addition, we
12 note that Stansted has a significantly greater level of spare runway capacity...”

13 But it was specifically referred to at 111 so how it can be said that we were counting it is
14 unclear. As was pointed out by Mr. Allan in the course of Mr. Green’s submissions, that is
15 also true of 286 where, as I say, it took a very conservative view to new runway capacity.

16 After all, we are well aware of the fact that the reality is that pressure for new runway
17 capacity is building. In fact, only last week the Chancellor indicated that, albeit not at
18 Heathrow, but there would be consideration of potential for new runway capacity. So
19 government policy does change. But that was left out of account.

20 Unless I can assist further in relation to ground two I was not intending to go into the
21 niceties of whether or not an AEC can or cannot be challenged in these circumstances,
22 because there is nothing in the ground whatsoever.

23 The Tribunal already has the submission about the structure of s.134/138 and so forth in
24 relation to AECs. That takes us down to ground three.

25 THE CHAIRMAN: Sorry, what did you just say?

26 MR. BEARD: I am sorry. At the outset where I was dealing with what the statutory framework
27 was under s.134 and s.138 I raised the issue that although matters that go to an AEC may be
28 subject to consideration under s.138(3) the statutory language is unclear whether you can
29 actually unpick an AEC.

30 THE CHAIRMAN: I thought you accepted that you can.

31 MR. BEARD: Certainly the same issues would arise. Whether or not you can unpick the AEC as
32 a matter for formality is not something that we stand on ceremony about.

33 THE CHAIRMAN: Just so we are clear, I had understood, when I asked you about it, you
34 accepted that one could imagine a case (leave aside this case) where what had changed was

1 such as to remove what had previously been an AEC so that it no longer had the
2 characteristics of an AEC.

3 MR. BEARD: That is right. Whether or not that means that the finding of an AEC in the prior
4 report is actually overturned is simply the matter of formality I am referring to.

5 THE CHAIRMAN: Right. I would have thought it would not be overturned, but it would not be
6 relevant any more.

7 MR. BEARD: It would not found a remedy any more. We entirely accept that as a matter of
8 practicality and fact the distinction may make no difference.

9 Then we move on to ground three which relates to the Competition Commission's analysis
10 of Stansted's recent profitability. That was one of the suggested material changes of
11 circumstance put forward by BAA. The suggestion was made that Stansted had suffered a
12 recent decline in profitability and in those circumstances the divestment was no longer
13 appropriate.

14 It is very difficult to understand how it is suggested that that could amount to an MCC in the
15 circumstances for two reasons. One is that Stansted is still profitable. There is no
16 suggestion to the contrary. In those circumstances, the argument that a still profitable entity
17 should, for some reason, not be divestible is one that we struggle to fully understand.
18 Really, that is the end of this matter. You do not actually need to go any further.

19 THE CHAIRMAN: I am so sorry, can you just give me that submission again.

20 MR. BEARD: Yes, it may well be worth turning up the 2011 Decision at para.245 just to
21 reinforce it. As you see, the headline on the opposite page is "The fall in Stansted's
22 profitability". This was the fourth of the suggested material changes in circumstance from
23 BAA. 245 is the start of "Our assessment".

24 "We have considered the strength of Stansted's financial position. We note
25 BAA's evidence that Stansted's profitability has declined since 2009, but also note
26 that it remains profitable. We would expect profitability to vary over the
27 economic cycle so we did not think that this in itself was strong evidence of a
28 MCC."

29 What is being said here is profitability has declined and you cannot now justify a
30 divestment. But that is just the wrong way round. What is relevant is whether or not there
31 is an AEC, whether or not there are concerns arising from that AEC that justify divestment,
32 and whether or not the divestment overall is proportionate. Not whether or not the entity is
33 profitable. You can well see a situation where a monopolist actually can run an asset that is
34 on a non-profitable basis because it effectively insulates competition against another asset it

1 holds. In those circumstances the argument that said you cannot order divestment of that
2 non-profitable asset would just be outlandish.

3 The only issue that profitability could ever potentially go to is whether or not Stansted is
4 marketable. There is no issue but that Stansted is well marketable. I will come on and deal
5 with that in relation to ground four. What ground three becomes is a discussion about some
6 rather technical accounting measures of profitability and comparisons that were done.
7 What the Competition Commission does in para.245 is say: it still remains profitable, that
8 really is the end of the matter.

9 “As noted in Appendix B, paragraph 17 and Table 5, the profitability of Stansted
10 compares favourably with that of several European airports (non-neighbouring
11 airports, along with Heathrow, Edinburgh and Glasgow)...”

12 THE CHAIRMAN: What is the point of making that point? If they only have to say it is
13 profitable they could look at its own accounts. Why were they doing this?

14 MR. BEARD: What was done was that when the point was made that Stansted’s profitability had
15 declined initially in response to the invitation to comment, the Competition Commission
16 looked at profitability more generally.

17 THE CHAIRMAN: Why?

18 MR. BEARD: Out of a general conscientiousness. It was not suggested that the profitability
19 relative to any other airport would have been a significant change. If the profitability levels
20 of Stansted had altered so radically in relation to a number of other airports, it might have
21 been that the Competition Commission would be asking itself did this have an impact on the
22 marketability of Stansted? Was there some sort of crisis going on? But it carried out an
23 investigation, but it did not for a moment suggest that low profitability would mean that
24 divestment was not appropriate at all.

25 But in any event, what the Competition Commission did was it looked at publicly available
26 data on comparative profitability and had a look at that data. It put it out in the provisional
27 findings that it provided after BAA had had an opportunity to comment. This was a point
28 picked up by Mr. Allan when Mr. Green was dealing with ground three. If you turn up tab
29 9 bundle B what you will see is an Appendix B entitled “Market conditions”. This is
30 looking at questions about the saleability of Stansted and whether or not there is some sort
31 of change in the market since 2009 which meant that it would become less saleable. Plainly
32 that is not the case. In fact, matters had improved since 2009 in terms of finance. Sir, I do
33 not think there is an issue in relation to that.

1 Right at the back of that Appendix is a table that sets out the commercial performance of
2 European airports.

3 THE CHAIRMAN: Just give us a minute to find it. (Pause) Yes.

4 MR. BEARD: So what you have here is a comparison of various airports and the figures in
5 published material for earnings before interest, tax, depreciation and amortization
6 (EBITDA), and then earnings before interest and tax (EBIT) and then you have got the
7 EBITDA and EBIT margins which are just those figures over total sales as a percentage
8 figure.

9 What the Competition Commission had done is in response to the suggestion that actually
10 Stansted's profitability had substantially declined such as to become an MCC, is ask: are
11 you still profitable? They carried out a very simple analysis of comparison with other
12 publicly available information. No criticism possible of that. That is what is discussed in
13 the relevant section of the 2011 Decision.

14 But since we are bundle B at the moment, what we have here is Table 5 being set out in the
15 provisional findings in relation to MCC.

16 THE CHAIRMAN: Sorry, does that paragraph and table get carried into the final table?

17 MR. BEARD: Yes. I would have to double check the precise wording of that paragraph, but the
18 table is identical.

19 THE CHAIRMAN: Are you able to give us the cross reference just so I can note it on this page?

20 MR. BEARD: Yes, it will be Appendix B to the 2011 Decision and it is para.18. I think the
21 wording is identical.

22 THE CHAIRMAN: Sorry, I am being slow here. Where do we have Appendix B to the 2011?

23 MR. BEARD: If you are in bundle A at tab 2, at the back of tab 2 there are tabs A and B. A is
24 the proportionality analysis; B is the market conditions appendix.

25 THE CHAIRMAN: Sorry, my tab does not seem to correspond with that. Bundle A tab 2.

26 MR. BEARD: Tab 2 is the 2011 Decision. If you work your way through to the back of the 2011
27 Decision.

28 THE CHAIRMAN: I have found Appendix A, then I have little tab B and I have got "Draft order,
29 BAA Ltd and Competition Commission". Oh, forgive me, I was looking at 1B.

30 MR. BEARD: Yes, 1B is an attachment to the Notice of Application, I think.

31 THE CHAIRMAN: Anyway, I have it. Sorry.

32 MR. BEARD: Market conditions again. Actually the plots are similar, but that is beside the
33 point. If one just turns on to the back of that appendix what you have is para.18 which I

1 think is in identical terms to para.17 in the provisional decision, and Table 5 which is
2 definitely in identical terms.

3 THE CHAIRMAN: Yes, the text seems to be the same.

4 MR. BEARD: Those behind me say that it is the same.

5 THE CHAIRMAN: It looks identical to me.

6 MR. BEARD: Yes. The criticisms are being made of Table 5 in the Decision. I was going to
7 take the Tribunal briefly back to bundle B because in bundle B we have BAA's response to
8 the Competition Commission's provisional findings which Mr. Green took you to briefly.
9 That is at tab 10, the next tab on. You will recall at p.15 of tab 10 there is a section entitled
10 "Market conditions relating to Stansted". Paragraph 66 says:

11 "The evidence the CC relies on [Appendix B, para.17 and Table 5] to support this
12 conclusion is a simple EBIT/EBITDA margin analysis."

13 The conclusion it is referring to is the one in 65:

14 "The CC examines...the strength of Stansted's financial position, and concludes
15 that the airport's profitability 'compares favourably' with that of several European
16 airports."

17 That is glossing the conclusion because the conclusion was: Stansted is still profitable and it
18 compared favourably with other airports based on the publicly available material. Then at
19 66 it refers to that material, but it does not engage in any further specific criticism of that
20 material at all. It does, however, make the general criticism that actually the Competition
21 Commission should be engaged in a wholly different exercise. The exercise it refers to is at
22 paras.72 to 74 just over the page on p.16, which the Tribunal has already seen, but I just ask
23 you to read it again. (Pause)

24 THE CHAIRMAN: Yes.

25 MR. BEARD: So what it is actually saying is: you have got this wrong, but in very broad terms.
26 It is not saying, contrary to Mr. Green's submissions, the three particular heads that he
27 raised as to why it was that there was concern in relation to these matters. Indeed, what it
28 says instead is back on para.68:

29 "The CC normally assesses profitability in Market Investigations using rates of
30 return on a depreciated replacement cost basis. [It cites the market investigation
31 guidelines.] The CC does not state the reasons for not using this approach in this
32 instance, nor does it consider the suitability of the margin based analysis."

1 What it is saying is you should have carried out some grander profitability assessment
2 exercise and reference to publicly available data is not enough there. But no specific
3 criticisms.

4 Could we then go back to para.245 of the 2011 Decision:

5 “As noted in Appendix B, paragraph 17 and Table 5, the profitability of Stansted
6 compared favourably with that of several European airports, with higher earnings
7 before interest, tax, depreciation and amortization (EBITDA) and earnings before
8 interest and tax (EBIT) margins than Amsterdam Schiphol ... and higher margins
9 than the forecast results for Frankfurt and Vienna. This indicates to us that, whilst
10 it is still seeing a decline in passenger numbers, it is producing healthy financial
11 results when compared with other airports. Moreover, in our judgment, a new
12 owner would be free to make independent commercial decisions that may be
13 different from those made by BAA, which also owns Heathrow, and Stansted’s
14 future operation and financial performance, including its growth ... would not
15 necessarily be in line with BAA’s projections.”

16 That goes to the point I was making earlier about a new owner being able to take over and
17 do something new, and therefore profitability as it stands at the moment under BAA’s
18 ownership is of limited relevance at the best of times.

19 “246. We have considered BAA’s representations on our assessment of Stansted’s
20 financial health. First, we note that BAA said that it saw the MCC in terms of
21 Stansted’s profitability relative to other airports. It also said that the Q5 regulatory
22 settlement was a readily-available benchmark for assessing Stansted’s financial
23 performance. BAA did not provide us with any analysis of Stansted’s
24 performance relative to other airports; it said, however, that the margin analysis
25 we had used as a basis for comparison was not sufficient for our purposes. Finally
26 it said we should not seek to infer anything about Stansted’s profitability from the
27 performance of other airports or from general market conditions but that we
28 should consider Stansted’s profitability on its own terms against appropriate
29 benchmarks.

30 “247. We note that the purpose of our assessment in this circumstance is not to
31 determine a regulatory settlement or establish levels of profitability compared with
32 cost of capital [That is the exercise that BAA had been saying we should do.] but
33 consider the impact of Stansted’s profitability on the marketability of the airport.
34 For this purpose, margin analysis and EBITDA performance does provide a

1 meaningful indication. We note that the board of BAA, when commencing the
2 sale of Gatwick, considered a presentation that looked at EBITDA multiples for
3 benchmarking likely disposal proceeds and did not consider other accounting
4 measures such as replacement cost returns.

5 “248. In our judgment, we do not need to conduct a detailed assessment of
6 Stansted’s current profitability of the type suggested by BAA, in order to reach a
7 view on whether there should be a delay in its divestment. Having noted that
8 BAA said Stansted’s profitability had reduced, but that it was still profitable
9 (despite having been through the low point of a recession and having had an
10 ongoing disagreement over airport charges with its major airline for over three
11 years), we conducted a simply comparison of publicly-available information. This
12 showed that Stansted’s EBIT and EBITDA margins were healthy compared with
13 other airports, despite its recent decline in passenger numbers. We note that there
14 is inevitably a limit to the amount of profitability analysis we can conduct on
15 different airports based on publicly available information, and believe we have
16 struck an appropriate balance to be able to conclude that Stansted’s financial
17 position should not be a barrier to its sale for a price which values its long-term
18 prospects.

19 “249. We conclude that Stansted’s profitability has reduced, but that its financial
20 results are healthy when compared with other, non BAA, airports. We consider
21 the implications of Stansted’s profitability and financial prospects in our
22 consideration of the divestment sequencing and timescales, from paragraph 287.”

23 You probably picked up, when reading through those paragraphs, 72 to 74 of BAA’s
24 submissions, that actually it was focused on timing of divestment rather than on whether or
25 not divestment should be made at all. But the point is a simple one: publicly available
26 comparison; it made perfect sense; it was still profitable; it was eminently marketable;
27 plainly there was not any MCC relating to the decline in profitability.

28 BAA then suggest that there is a range of particular errors in relation to the way that we
29 have carried out the EBIT and EBITDA comparison analysis. The focus is on a criticism of
30 the EBIT analysis. I should say just for reference, because this becomes rather detailed, the
31 relevant paragraphs of the defence are paras.91 to 94. BAA were saying that we were not
32 comparing like with like in the particular circumstances of this case because actually
33 Stansted’s accounts were dealing with matters which included exceptional items for the
34 EBIT figure, but that exceptional items were excluded from the comparator airports.

1 It was not a matter of calculation. We were simply taking the publicly available material.
2 The fact that certain exceptional items were or may have been taken into account by those
3 other airports really did not make any difference in that sort of broad brush analysis that was
4 being undertaken, as is set out here.

5 Indeed, it is worth noting that the term “exceptional item” is one of some contention as to
6 precisely what is and what is not an exceptional item for inclusion. So it really does not
7 take anyone anywhere to quibble about those sorts of matters. But more importantly than
8 that, the criticism is in relation to the EBIT comparisons. The EBITDA comparisons that
9 were highlighted, which were the very ones that Gatwick under BAA’s ownership was
10 using when deciding what sort of divestment proceeds it might be looking for, are not
11 impugned in any of the criticisms in any event. So it is very unclear, even if you get down
12 to this level of granularity, why it matters one iota. Quite fundamentally, it is a wrong
13 measure for assessing whether or not the divestment should go ahead. The fact that the
14 Competition Commission carried out this sort of broad analysis was perfectly valid. None
15 of these specific criticisms was levelled at Table 5. So it is harsh and unfair in fact for BAA
16 now to be raising them when it could have raised them earlier. In fact, they do not take it
17 anywhere, because these discussions about where exceptional items should lie in relation to
18 EBIT figures do not impugn either the general finding on profitability, or indeed anything to
19 do with the EBITDA figures in any event.

20 In relation to those matters, there is nothing to be added. The other two grounds that Mr.
21 Green put forward were that the comparators might use group results and they might
22 involve different income streams. Yes, and yes, but when you are looking at publicly
23 available data you cannot just go and disaggregate all of these matters, nor was there any
24 need to. All we were doing was carrying out some kind of very broad sense check against
25 what was being said to us. We explained in the report specifically why the sort of
26 profitability assessment that BAA was proposing was not appropriate here. Those detailed
27 profitability assessments that are referred to in the marketing investigation guidelines are
28 when you are looking at a company and deciding whether or not it has got market power
29 and you are looking at the sort of scale of market it has, one of the measures you look at is
30 what sort of level of profitability it has. If it has huge profitability it might suggest that it
31 does have a degree of market power. That is a completely different exercise from what we
32 were engaged in here.

33 THE CHAIRMAN: Yes, is that a convenient moment for the five minute break?

1 MR. BEARD: Yes, I am sure it is. That, I think, concludes on ground three and that just leaves
2 ground four.

3 THE CHAIRMAN: Very well, five minutes.

4 (Short break)

5 THE CHAIRMAN: Yes, Mr. Beard?

6 MR. BEARD: I have dealt with ground 3, and I will deal now with ground 4. Ground 4, broadly
7 speaking, as we understand it, even if you did the proportionality exercise correctly, and
8 there is time to set up a proper sale, so that you are not in fire sale territory, there is actually
9 some additional loss to BAA that is not captured otherwise in that exercise.

10 As noted in the defence, this issue has never been raised previously in the substantial
11 consultation exercise on the consideration of potential MCCs, and that alone is a basis for
12 dismissing ground 4, because if BAA really thought there was a loss of this sort it should
13 have explained it, put it forward, enabled the CC to consider it.

14 I briefly took the Tribunal to sections of the 2011 decision dealing with the assessment of
15 proportionality and the relevant costs that have been suggested by BAA. I think it is worth
16 just re-emphasising that in Appendix A to the 2011 decision. At para.2:

17 “We look first at the expected relevant costs of divestiture of Stansted. We then
18 consider the likely benefits of divestiture of Stansted. We then consider the likely
19 benefits of divestiture. The appendix builds upon the proportionality assessment
20 contained in Section 10 and Appendix 10.3 of the 2009 report and takes account of
21 changes and new information provided since publication of the 2009 report. The
22 approach to proportionality in the 2009 report was challenged by BAA before the
23 CAT. This challenge was not successful and the CAT upheld the CC’s approach.”

24 I can take the Tribunal to Appendix 10.3 but given time I think perhaps it is just more
25 sensible to focus on the points raised by BAA in relation to these matters.

26 Paragraph 4 of Appendix A:

27 “Our approach in relation to the costs of divestiture was to review BAA’s
28 submissions and the supporting breakdown of estimated costs with an appropriate
29 level of scrutiny. As in the 2009 report, we considered the substantiation of the
30 cost estimates and whether the estimated costs were appropriate and reasonable. In
31 comparing costs with likely benefits of divestiture we have used BAA’s cost
32 estimates which we consider to be at the upper end of the likely net relevant costs
33 of divestiture. In considering the benefits, we have taken account of relevant
34 changes and new evidence provided since the 2009 report.”

1 Obviously, that is what I was dealing with at the back end of the ground 1 submissions.
2 Then: “Expected relevant costs of Stansted divestiture. Estimate used in the 2009 report”.
3 I referred you to that. Then “Economies of scale” are again considered, para.10:

4 “BAA said that in the provisional consideration document ----

5 THE CHAIRMAN: Just as we go para. 5 it is just worth noting the use of the definite article
6 “The three categories of costs that BAA identified.”

7 MR. BEARD: Yes, absolutely. Again, I am loathe to put too much weight on any particular
8 word in the text book. Clearly this is what BAA was putting forward.

9 THE CHAIRMAN: Well it is certainly what the Competition Commission understood them to be
10 putting forward ----

11 MR. BEARD: Yes, absolutely.

12 THE CHAIRMAN: -- I do not think I have been shown anything that would suggest that their
13 understanding was wrong.

14 MR. BEARD: No, absolutely not. At para.10 on economies of scale:

15 “BAA said that in the provisional consideration document the CC appeared to have
16 double counted potential benefits to competition within current constraints. It said
17 that the 2009 report acknowledged potential benefits of common ownership as a
18 result of economies of scale were around £29 million for the three airports. BAA
19 further proposed that if the £29 million benefit of common ownership were to be
20 netted off through capital and operational efficiencies this was assumed to be the
21 result of common ownership, then these efficiency benefits could not be counted
22 again when measuring the potential benefit of competition relative to the cost of
23 divestment.”

24 I am not going to even try and unpick those submissions. The point is just a simple one.

25 BAA was coming back and saying: “Your economies of scale analysis that you had used in
26 2009, you have to revisit that for various reasons, and then in paras. 11 through to 17 we go
27 through and say: “Actually, no, that is not right, and your economies of scale argument does
28 not amount to anything”.

29 Then we move on to the unquantified benefits of common ownership which ----

30 THE CHAIRMAN: Why are we taking time on this? I thought that the point you made was that
31 he did not raise the point ----

32 MR. BEARD: If that is the case I will not labour it. The point I was raising, it was in the context
33 of ground 4 it has been said: “You did not consider key losses in relation to these matters.”

34 THE CHAIRMAN: Right.

1 MR. BEARD: The point I am making is actually, we did consider three heads of loss. The three
2 heads of loss that had arisen in 2009 that BAA knew that we had considered, they engaged
3 with that, they did not raise anything else. In those circumstances ground 4 should fall at
4 the first hurdle effectively, because you cannot come along and challenge a decision on the
5 basis of stuff you did not put forward, you did not ask us to take into account, you did not
6 seek to quantify, you did not seek to qualitatively assess.

7 THE CHAIRMAN: I think we have the point. Am I right in thinking that these paragraphs in
8 Appendix A of the final report were in the provisional report or something equivalent?

9 MR. BEARD: Yes, I think broadly equivalent were, but we will double check that. Whilst I am
10 making final submissions Mr. Bates will look.

11 THE CHAIRMAN: It seems to me that point is worth noting because it would reinforce the point
12 that you are making, that they knew in detail the analysis that was being adopted and did not
13 take the opportunity to say: "There is an additional ----"

14 MR. BEARD: Yes.

15 THE CHAIRMAN: Is that right?

16 MR. BEARD: Yes, the points are made in relation to this in Appendix A, which are the
17 provisional findings at tab 9 of bundle B.

18 THE CHAIRMAN: We can look at that for ourselves in due course.

19 MR. BEARD: Yes, it is Appendix A to the 2011 Provisional Decision, tab 9, bundle B.

20 THE CHAIRMAN: Thank you.

21 MR. BEARD: It is not in precisely the same form. It is not like table 5 ----

22 THE CHAIRMAN: Which was identical.

23 MR. BEARD: Yes, it was identical.

24 THE CHAIRMAN: Is this right, that one gets the substance of the three points?

25 MR. BEARD: Undoubtedly, yes. The first paragraph says that these are the three points that
26 were highlighted in 2009, that is in almost identical terms to para. 5 of the final decision.

27 THE CHAIRMAN: Yes, thank you.

28 MR. BEARD: That is the starting point. So if we have to engage with ground 4 at all, which we
29 say we should not have to, actually it does not tell us anything because what is essentially
30 being said is if you can get a market value for Stansted still in addition to that there is some
31 other loss. Now, to us this almost feels like what philosophers call a "category error"
32 in that you do not ask what blue smells like? Similarly you do not ask what loss is incurred
33 when you have achieved market value. Once you have market value for an asset the idea

1 that you are suffering any additional loss in relation to it is one that simply does not make
2 sense in this context.

3 Mr. Green started trying to say you should start from the freedom of contract perspective
4 and we were giving up freedom to contract. They were obviously giving up the freedom to
5 contract but they were not just giving up the freedom to contract, they were giving up
6 Stansted, that is what the order was. But you have to give up Stansted, that is the
7 divestment order but if you achieve a market value for it you are not suffering any loss.
8 It is quite right that the CC, both in 2009 and 2011 carried out a careful qualitative analysis
9 of how the divestment period and arrangements should be structured, so that you did not
10 end up with a fire sale so that you were artificially lowering the market value of the asset.
11 There is no doubt about that.

12 Indeed, in the 2011 decision this is considered in some detail, this reflects the approach
13 carried out in the 2009 report. It starts at para.287 of the main text of the 2011 decision.
14 Headline: "Issues regarding details of the divestment process".

15 THE CHAIRMAN: Yes.

16 MR. BEARD: So we have issues concerning the divestment process, and then "Simultaneous or
17 sequential divestment", so one of the concerns was that you could be imposing an undue
18 burden on BAA if you required simultaneous divestment, which would otherwise be the
19 starting position because obviously you want to remedy the AEC as quickly as possible, but
20 it was decided in the light of BAA's submissions that that would be not appropriate.
21 Then, if you turn over the page, the heading at para. 298: "Sequencing of divestment"
22 because one of the long arguments BAA had was that Stansted should go second now. In
23 2011 it was required that the Scottish airport would go second, Stansted would go first.
24 BAA said that "One of the concerns that led you to want Stansted first was it could get the
25 SG2 planning application through." That has now gone so it does not matter so much. That
26 evidence was all considered and it was decided by the CC that in fact Stansted should still
27 go first. Obviously, that has now changed, in light of the interim relief.
28 Then you move on to just above para. 311 which talks about "Impact on divestment
29 periods". Here is a consideration of BAA's submission about why divestment periods
30 should be longer. Some of those pieces of information are confidential.
31 Then the CC carries out its assessment at 317 and deals with first BAA's points about delay
32 not having any impact and so on and so forth. Then it goes through and considers BAA's
33 submissions, and in particular at 323 it says:

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

9 Then it considers some points made in the 2009 report and the CAT Judgment about that to
10 which the Tribunal has already been referred, where the CAT upheld the divestment periods
11 that had been put in place in 2009, and that is confirmed at 326:

12 “The CAT concluded that we should take account of the loss of proceeds in
13 designing the remedy package, and that we had indeed done so. BAA is
14 effectively asking us to revisit that analysis on the basis that since the report the
15 value of Stansted has decreased, increasing the risk of depleted proceeds if it is
16 required to divest in the near future.”

17 Then 327:

18 “There is a tension in extending the divestment process between reducing the risk
19 of depleted proceeds for shareholders on the one hand, and extending the duration
20 of the consumer detriment arising from the AECs identified on the other hand. In
21 the 2009 report, we found the appropriate balance through the choice of divestment
22 period and use of sequential divestments (with a limited overlap). In our view, that
23 remains the appropriate balance. Stansted’s passenger numbers have decreased
24 since the 2009 report’s publication. On the other hand, having noted BAA’s
25 submissions that Stansted’s profitability has declined since the 2009 report, we
26 found that recent figures show it compares favourably with that of several
27 European airports, and we were told that since 2009 investor appetite for assets
28 such as airports has increased. And we found that market conditions for
29 divestment have improved since 2009 ...”

30 and that goes back to the market conditions annex at the back of which is table 5.

31 “In the meantime, customers have felt and continue to feel, substantial detriment
32 from continued common ownership over this period.”

33 It also notes, somewhat ironically – I will not read it out – what is said by BAA in relation
34 to the first couple of lines, so no sense of suggestion of change in 328. Then at 329 specific

1 points about the imposition of deadlines for conducting the sales' processes. Consideration
2 of arrangements for the sale of Gatwick and so on and so forth. 330:

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

11 331 We have not identified anything relating to the time taken to sell Gatwick that
12 would lead to a conclusion that the time required to sell other airports should be
13 increased from the X set out in the 2009 report. There is no reason to change how
14 we define the starting point for the divestment period."

15 So essentially, the qualitative assessment as to the structure of the divestment period was
16 carried out in 2009, that is what Mr. Swift was referring to in the sections of the
17 submissions to which Mr. Green referred. I will not go through those because they do not
18 really add anything, but just for your notes, p.34 lines 14 to 19 of the transcript at tab 1 of
19 Mr. Green's additional bundle, and p.35 line 17 onwards through to 36.11 which is where
20 Mr. Green picked it up, indicate that what the Tribunal was concerned about, and what Mr.
21 Swift was talking about was the qualitative assessment of the setting of the divestment
22 period, which was something that was considered in some detail in the 2009 report in
23 section 10 of the report. That was the qualitative assessment that was being dealt with.
24 You were taken through the CAT Judgment in some detail by Mr. Green. I was not going
25 to revert to that. As the Tribunal commented in the course of Mr. Green's submissions,
26 those matters were plainly in relation to the qualitative assessment as to whether or not the
27 divestment period would result in a fire sale. Unless the Tribunal wishes me to go through
28 those particular provisions that you went through at some length yesterday, and given the
29 time I was not going to do so, but the CC's submission is that is plainly what is going on
30 there. It was a discussion of whether or not the divestment period ensured you did not have
31 a fire sale so you could get market value. The CC's approach in 2009, which was for the
32 same period was approved by the CAT having had that scrutiny.

33 THE CHAIRMAN: Sorry, you just said that was dealt with in section 10. Section 10 is very
34 long, can you give us the paragraph. Perhaps your Junior can tell us.

1 MR. BEARD: Yes, I am sorry. My notes are slightly muddled on this and I have asked Mr.
2 Bates to look at it already and I realised I had missed that.

3 THE CHAIRMAN: Right.

4 MR. BEARD: In those circumstances what we have is a situation where we simply do not
5 understand what this putative loss was; it was never put forward. We structured the
6 arrangements to ensure divestment so as to avoid a fire sale, and that qualitative assessment
7 has been approved once by this Tribunal and we have not seen anything subsequently to
8 suggest that that approval process was wrong. Indeed, to the contrary we have actually seen
9 an improvement in market conditions because, of course, in 2009 we really were in the
10 depths of a financial crisis. So when you are talking about divesting a substantial asset you
11 might have thought if there was going to ever be a problem that a fire storm there was as
12 fierce as might ever be expected.

13 Mr. Bates has very kindly turned up the reference: section 10, it starts at 10.155
14 “Considerations on timing”, 10.156 onwards, specifically in relation to the timing of the
15 Stansted divestiture, 10.165 onwards, and then the decision on the timing of divestments
16 10.182.

17 THE CHAIRMAN: Just out of interest, was it part of BAA’s appeal in relation to the 2009
18 report? Sorry, it clearly was part of their attack on the Competition Commission’s ruling
19 because we saw it dealt with in the CAT’s Judgment.

20 MR. BEARD: Yes.

21 THE CHAIRMAN: When there was an appeal up to the Court of Appeal ----

22 MR. BEARD: No, it was bias only, is my understanding.

23 THE CHAIRMAN: Right.

24 MR. BEARD: They lost on proportionality ----

25 THE CHAIRMAN: And it stopped with the CAT.

26 MR. BEARD: -- and they did not pursue it, yes. I am sorry, I was not involved in that hearing
27 but I understand that was the case, and the Court of Appeal then overturned the bias finding,
28 so there was no respondent’s notice and cross appeal, which is what would have been
29 required.

30 As I say, the difficulty we have is that even if you were to say that ground 4 should be
31 considered we just do not see what loss is being talked about, and the visceral feeling of:
32 “Well, I lose a feeling when I am told to sell something” that may be right but as a matter of
33 the analysis of loss it does not amount to anything. Indeed, it is worth noting that in any
34 divestment process this argument would arise and yet it has never arisen in relation to any

1 merger divestments so far as we are aware and, indeed, there will be other circumstances
2 where a similar argument could be raised, for instance in relation to compulsory purchase
3 valuations, but there what you have there is an open market valuation and no sense that the
4 fact of compulsion changes the value of the land being sold. So in those circumstances we
5 do not see anything in ground 4, and the suggestion that somehow the letter written by the
6 Treasury Solicitors, of 30th September, which said: “We have not carried out a further
7 qualitative assessment in relation to the loss that you have put forward” betrays some
8 change from 2009 and what was put before the Tribunal; it is just not right. What was done
9 in 2009 and here was a qualitative assessment of the divestment period, not some sort of
10 qualitative assessment of some putative other loss – indeed, none was put forward.

11 THE CHAIRMAN: Yes.

12 MR. BEARD: Unless I can assist the Tribunal in relation to ----

13 THE CHAIRMAN: Just by clarifying what I think is implicit in what you have just said, that you
14 are not actually maintaining an alternative discretion argument by reason of the extension of
15 the period. If you remember, we had the debate on the first day and you said there was a
16 theoretical basis on which it might arise?

17 MR. BEARD: The reason it was maintained was this ----

18 THE CHAIRMAN: I am not criticising you, I just want to be clear it does not arise now.

19 MR. BEARD: The only reason it could possibly arise now is if it was found by the Tribunal that
20 somehow, even though it is not raised as a ground, the divestment period that had been set
21 in the 2011 decision, was somehow was a fire sale time that did not allow market value to
22 actually be achieved. If you were now considering the reality of the situation with the
23 flipped arrangement that would not be the right approach; that is the only way in which that
24 could possibly arise now, so far as we could see.

25 THE CHAIRMAN: Well, I am not quite sure how that would work through. If we did find that,
26 contrary to your primary submission, the period was so short as to amount to a fire sale, I
27 agree that is not the way Mr. Green is putting it ----

28 MR. BEARD: No.

29 THE CHAIRMAN: -- but let us suppose that were the case, would the natural consequence of
30 that not be to put back for a further decision by the Competition Commission ----

31 MR. BEARD: No, because if the fire sale aspect is just a timing issue then you now have a longer
32 period of time with which you are dealing, so “no” is the answer. That is the only reason
33 we reserved the position. It is not actually ground 4, but just because of the ----

1 THE CHAIRMAN: So would the submission – just so I am clear – be that this Tribunal is fully
2 appraised of everything that would be needed to make a judgment as to whether it is or is
3 not a fire sale, even if we decided that the period was too short in the 2011 decision, such as
4 to amount to a fire sale. You say: “We [the Tribunal] can see that with the flipped
5 arrangement that problem has gone away”?

6 MR. BEARD: Essentially you cannot reach a conclusion that there is a possibility of a fire sale
7 on the basis of the flipped arrangement but, as I say ----

8 THE CHAIRMAN: Just tell me what the flipped arrangement is you are inviting us ----

9 MR. BEARD: I cannot give you the timing openly, but the arrangement in the undertakings is
10 simply that the Scottish airport goes first, and Stansted goes second with a degree of overlap
11 in the processes.

12 THE CHAIRMAN: Is there any reference in the bundles where we can see in confidential form,
13 the periods? Or, if not, can we be sent a note?

14 MR. BEARD: Yes, we will provide you a note because the undertakings that were entered into
15 set that out, and it is also worth mentioning just in connection with ground 4, that actually
16 those undertakings do include a communication clause that if something very radical were
17 to happen there is a residual ability to come back to the CC. As I say, I am very cautious to
18 even reserve the position of the CC in relation to those matters, because it is not the way
19 that ground 4 has been put and it is just as a matter of final propriety in relation to those
20 issues.

21 THE CHAIRMAN: Yes, thank you.

22 MR. BEARD: Indeed, if that is how the case is put there may be a need for some further
23 submissions in any event.

24 THE CHAIRMAN: Yes.

25 MR. BEARD: Unless I can assist the Tribunal further.

26 THE CHAIRMAN: Yes, thank you. Mr. Harris?

27 MR. HARRIS: Sir, I have a short number of additional points to supplement those of Mr. Beard.

28 THE CHAIRMAN: Right, so first of all, can you identify the point Mr. Beard has missed, and
29 then tell us what submission you want to make.

30 MR. HARRIS: The first point is that the service quality analysis was criticised by Mr. Green, Mr.
31 Beard dealt with the service quality analysis that the CC had performed, but did not deal
32 with Mr. Green’s additional submission that there was a lack of causal relationship between
33 the change of ownership and the service quality improvement. I propose to show you two

1 new documents that demonstrate clearly that there is a causal relationship between quality
2 improvement and new ownership – with your permission?

3 THE CHAIRMAN: Well, show us the paragraphs in the report.

4 MR. HARRIS: The documents that I propose to show you on this are not in the 2011 report, they
5 are in the consultation that led to the 2011 report.

6 THE CHAIRMAN: Show us the relevant paragraphs in the 2011 report first so we know what
7 you are talking about.

8 MR. HARRIS: Yes, principally it is para.102 which cross-refers back to para 53 of the 2011
9 report.

10 THE CHAIRMAN: So that is referring to paras. 53 and 54 of Appendix A.

11 MR. HARRIS: Well it is 53 and 54 in the main report and Appendix A, the most important one is
12 para.53 of the main, 2011 report.

13 THE CHAIRMAN: We have been shown 53.

14 MR. HARRIS: Yes, and Mr. Green’s additional criticism was that what you have not been shown
15 is that service quality improvement at Gatwick arose as a result of – was causally connected
16 with – the fact there was new ownership at Gatwick and, in particular, he criticised the line
17 in para. 102 of the 2011 report, which is about three sentences in, which reads:

18 “We would expect benefits from service quality improvements to continue at
19 Gatwick and to intensify with further competitor rivalry and also to arise at
20 Stansted once it is independently owned.”

21 He said there was no basis for concluding that the service quality improvements arise
22 because of, causally related to, new ownership. Mr. Beard showed you 53 to show that
23 there are lots of service quality improvements and that they had been analysed and what I
24 propose to do is to show you a different document.

25 THE CHAIRMAN: So is your submission that the report fails properly to deal with the causal
26 connection, but you are going to say that there is another document that deals with it?

27 MR. HARRIS: No, effectively what I am going to show you is the document -----

28 THE CHAIRMAN: Well if you are saying that the 2011 report deals with the causal connection
29 show us where it does that.

30 MR. HARRIS: Well it says: “once it is independently owned”, so that is the causal connection
31 that Mr. Green criticised.

32 THE CHAIRMAN: Right.

1 MR. HARRIS: And I am going to show you a document that substantiates, if you will allow me,
2 "once it is independently owned", in other words the causal connection and you have not
3 seen that document.

4 THE CHAIRMAN: All right.

5 MR. HARRIS: It is in bundle F, a bundle of which you have not seen a great deal, and it is at tab
6 9.

7 THE CHAIRMAN: So is this a document that the Competition Commission failed to deal with
8 other than by that one sentence in para. 102?

9 MR. HARRIS: Yes, it does not deal, save in 102 ----

10 THE CHAIRMAN: Just so I am clear, do we need to bear your submission in mind in relation to
11 whether sufficiently good reasons have been set out by the Competition Commission? You
12 seem to be saying that there is additional material that one needs to go to to explain their
13 reasoning?

14 MR. HARRIS: Well I would not go so far. My submission would be ----

15 THE CHAIRMAN: No, that is why I keep focusing on the 2011 report, because if you are going
16 to other material it potentially leaves us with the impression that you are implicitly
17 accepting that there is a defect in the 2011 report, are you doing that?

18 MR. HARRIS: Let me make it clear, I do not accept there is a defect in 2011.

19 THE CHAIRMAN: Right.

20 MR. HARRIS: Mr. Green, however, alleged that there was a defect in 2011 and he points to that
21 as being insufficiently substantiated, that phrase: "once it is independently owned", and in
22 order to allay any suspicions that you might have that there was anything at all in Mr.
23 Green's submission I am going to show you the key document – two pages – that underlies
24 that finding by the Commission in the middle of 102 of the 2011 report.

25 THE CHAIRMAN: Even though the Commission do not themselves refer to it? That is the
26 position, you are saying: "They do not refer to it, there is this one sentence, but there was
27 material that they could rely upon"?

28 MR. HARRIS: Yes. What I was invited to do was give additional points of response to Mr.
29 Green's submissions that Mr. Beard had not dealt with, and that is all I am doing here.

30 THE CHAIRMAN: Right.

31 MR. HARRIS: So if you have regard to this document at tab 9 in bundle F, this is the submission
32 that was presented to the CC prior to it writing in para.102 from the new owner of Gatwick
33 Airport in January of this year, and it is quite clear just from the first paragraph, let alone

1 the other paragraphs, that it is setting out new “management priorities”, that is in the first
2 sentence.

3 THE CHAIRMAN: I thought that we had been told about lists of new management priorities in
4 the report itself, but you are saying that just is not dealt with in the report?

5 MR. HARRIS: I think what you get, in 53 and 54 you get the list of things that Gatwick has done.

6 THE CHAIRMAN: Right. Yes, I think that is what I had in mind, so should we not be looking at
7 that if that is where they deal with the list of changes.

8 MR. HARRIS: Yes, it is a much narrower point. Mr. Green was criticizing, he was driven to
9 submit after it was clear that there had in fact been service quality improvements, including
10 when you, sir, took him to 53 that he did not go to. He was then driven to submit that:
11 “Yes, there are lots of service quality improvements after all. Look there is a big list there
12 but there is nothing to show that they were caused by the change in ownership”. That was
13 his additional submission.

14 THE CHAIRMAN: Right.

15 MR. HARRIS: What I am saying to you is that there is material to substantiate the CC’s finding
16 in 102 that they arose out of or were causally connected with the new ownership.

17 THE CHAIRMAN: Did you not get that from 53, a list of changes since it had been under
18 separate ownership?

19 MR. HARRIS: Sir, I am entirely happy. If you consider that that is sufficient to deal with
20 Mr. Green’s criticism ----

21 THE CHAIRMAN: I am just trying to understand your submission at the moment. You seem to
22 be submitting that there is nothing else in the 2011 report other than that sentence in
23 para.102 to support the inference that the changes have been as a result of ownership. That
24 is what you told us.

25 MR. HARRIS: Sir, it is because of Mr. Green’s submission. It does not say in 53, for instance,
26 “Gatwick provided us with a list of changes since it had been under separate ownership that
27 were caused by the fact of new ownership”. Mr. Green therefore criticises the report for not
28 doing that.

29 THE CHAIRMAN: Does it come to this: that we can make a side note against para.53, “See tab
30 9 in your materials”?

31 MR. HARRIS: Yes, and also see tab 11, the first sentence of para.3 of a letter from the Civil
32 Aviation Authority.

33 THE CHAIRMAN: That is not a side reference to para.53, because that is not talking about the
34 Civil Aviation Authority.

1 MR. HARRIS: It is the same point, because if you look at the first sentence of the third paragraph
2 on p.106 behind tab 11, it is further evidence that was presented to the CC in the course of
3 the consultation that it was separate ownership that had led to positive changes in the
4 airport's behaviour. So it is further evidence of the causal connection.

5 THE CHAIRMAN: The paragraph in the report where we note that is what?

6 MR. HARRIS: It is the same, it is either 53---

7 THE CHAIRMAN: It is not 53 because that is Gatwick providing us with a list of changes.

8 MR. HARRIS: It is an additional note. Gatwick providing you with it, and then you could put in
9 parenthesis "and the CAA provided us with".

10 THE CHAIRMAN: Even though the Competition Commission do not say that?

11 MR. HARRIS: Yes, and if you want another cross-reference paragraph there is a heading at 58 of
12 the 2011 report.

13 THE CHAIRMAN: So we add that to the list of references?

14 MR. HARRIS: Yes.

15 THE CHAIRMAN: So it is 102, 53 and 58?

16 MR. HARRIS: Yes. Sir, that is all I need to say on that point.

17 If you do get a moment to look at the document behind tab 9, you will see that in most of
18 those paragraphs they are referring expressly to the fact that the changes have arisen from
19 new management priorities, new leadership culture, a new close management team ---

20 THE CHAIRMAN: I think we have got the point. We are going to read the document.

21 MR. HARRIS: Thank you. The next point, if the Tribunal would be assisted, but plainly not if it
22 will not, is two paragraphs in the 2009 judgment, which is in tab 2.

23 THE CHAIRMAN: First of all, what is the submission that Mr. Beard failed to make that you
24 now want to make?

25 MR. HARRIS: Mr. Beard did not, as I noted, refer you to para.251, which is an exemplification
26 of the fact that in the previous challenge this Tribunal dismissed the suggestion that you
27 should read something like a statute and that it was improper for reasoning to be spread out,
28 or, to use Mr. Green's phrase, "dotted about within the main report".

29 THE CHAIRMAN: All right, we will look at 251 in due course.

30 MR. HARRIS: I am grateful. The third point was what you engaged in with Mr. Beard about the
31 relevance to the standard review of the fact that human rights are engaged, and I would
32 invite you to look at 246 as well of the previous judgment in 2009, because of course human
33 rights in the form of A1/P1 were engaged in 2009 as well. The Tribunal concluded that the

1 standard should be “a margin of appreciation with the exercise of which a court should be
2 very slow to interfere”, notwithstanding that engagement of human rights.

3 THE CHAIRMAN: Yes, thank you.

4 MR. HARRIS: The next point is that in the 2011 report at para.231 – this is on the issue of
5 substitutability. Mr. Beard ----

6 THE CHAIRMAN: The submission that Mr Beard failed to make.

7 MR. HARRIS: Mr. Green’s criticism was, “Actually the airports are not very substitutable”,
8 Mr. Beard’s response was, “Look at all this analysis of how they are very substitutable”.
9 My additional point is that the criticisms that Mr. Green makes of substitutability amount to
10 no more than challenges that he made unsuccessfully before the 2009 report and are just
11 repeated as a matter of substance. In 231 of the 2011 report the CC says exactly that. So I
12 would invite you to read ----

13 THE CHAIRMAN: Paragraph 211, did you say?

14 MR. HARRIS: Paragraph 231, and the crucial sentence is:

15 “BAA in its written evidence simply continues to disagree with our 2009
16 assessment”.

17 That is no ground for judicial review. That is my point.

18 THE CHAIRMAN: All right, thank you.

19 MR. HARRIS: I am nearly there, Sir. A submission that was made yesterday was “it has never
20 been suggested that there can be off-peak capacity competition between London Heathrow
21 and Stansted – that was Mr. Green’s submission. Mr. Beard pointed out those respects in
22 the 2009 report in which there is bilateral competition between London Heathrow and
23 Stansted. My additional point is that when Mr. Green submits it has never been suggested
24 that there can be off-peak capacity, that is not right, because Ryanair has made that exact
25 submission, and you will see that in our statement of intervention and our materials for the
26 consultation. We point out that there is huge under-utilisation of the ----

27 THE CHAIRMAN: Is that reflected in the report? You do not have the reference?

28 MR. HARRIS: No, I do not have a reference for that. I can look for one. Sir, the final point is
29 simply that rather the game was given away, we respectfully submit, yesterday when
30 Mr. Green submitted, and I quote, “The competition in the airport market is very far from
31 perfect”. Indeed, we completely agree, it is imperfect because BAA still has a dominant
32 position, and the longer that that goes on, the more harm to consumers endures.

33 THE CHAIRMAN: I thought that was a submission Mr. Beard had made.

34 MR. HARRIS: Sir, that is my final point.

1 THE CHAIRMAN: All right, yes. Thank you very much for coming. Yes, Mr. Green.

2 MR. GREEN: My Lord, I will take the points that Mr. Beard has made in sequence and I will
3 deal with them as fast as I can.

4 First of all, I have got a short observation to make about the relevant principles and
5 Mr. Beard's submission about the intensity of review. I will make the submissions in this
6 way: this goes to both the depth of the analysis required by the Commission and the
7 supervisory function of the Tribunal. We have, and we do rely upon A1/P1, as I think you
8 have observed. That is in our pleaded skeleton, para.20. We rely also on *Tesco*, para.139,
9 double proportionality. I think that means no more than the more severe the remedy the
10 more conscientious the task that has to be conducted by the regulator. It probably means no
11 more than that.

12 At your leisure, and I can take you to it now if it would help, the Tribunal in *UniChem*,
13 paras.168, 179 and 194, refers to the European Court's ruling in *Tetra Laval*, and says that it
14 is similar to the judgment of the Court of Appeal in *IBA* about judicial review in
15 competition cases. It simply supports the conclusion that there is a more intense form of
16 review. We had a chance to look at the *Vogt* case that you referred to, and ----

17 THE CHAIRMAN: That may have been a wild goose chase, and I apologise if it was.

18 MR. GREEN: I think, in fact, it says something which is really rather similar to – we were trying
19 to look at it on the screen here – *Tetra Laval*, similar to *IBA*. It is supportive. I do not think
20 it goes any further than that.

21 Finally, on this issue, *ex parte Khatun* was a case which concerned the exercise of
22 discretion under the Housing Act. It was never submitted that it concerned an issue relating
23 to intense review or the European Convention on Human Rights.

24 THE CHAIRMAN: Just on intensity of review, which is the best of the references that you want
25 us to look at?

26 MR. GREEN: It is really *Tesco*, 139.

27 THE CHAIRMAN: Let us look at that then.

28 MR. GREEN: That is just double proportionality. You have seen that, I do not want to repeat ----

29 THE CHAIRMAN: I thought you were saying that was your best reference.

30 MR. GREEN: The references I have given you, I think, are probably the best ones, those
31 paragraph numbers. The other English one ----

32 THE CHAIRMAN: Shall we look at *UniChem* then?

33 MR. GREEN: *UniChem* may be helpful, yes. It is authorities bundle 1 of 2, tab 22, para.168,
34 p.67. I should just explain the difference between this case and the present case. This was a

1 merger case before the European Court and *UniChem* was a merger case under the Office of
2 Fair Trading's jurisdiction, but the overall principles of judicial review are, we submit, the
3 same. I would just ask you to read that paragraph.

4 THE CHAIRMAN: (After a pause) Right.

5 MR. GREEN: Two points were made as to its significance. The second one is not relevant. The
6 first in para.169, we regard that approach as close to that of the Court of Appeal in *IBA*,
7 which is the only occasion on which the Court of Appeal has addressed the scope of
8 supervisory intensity in the present case.

9 THE CHAIRMAN: So is *IBA*, in fact, not the binding authority that we should have a look at?

10 MR. GREEN: Certainly, that is the authority which *Barclays*, *Tesco* and all other cases take their
11 essential *locus* from. Also paras.170 to 174. For present purposes this evening I think it
12 suffices to look at para.174, citing Lord Justice Carnwath in *IBA*.

13 THE CHAIRMAN: Yes. That seems to be a *Wednesbury* type approach. Looking back at 171,
14 "The Court of Appeal in *IBA*" ----

15 MR. GREEN: It is explaining how intense the review would be in the circumstances.

16 THE CHAIRMAN: The test is as set out in *Tameside*.

17 MR. GREEN: It says:

18 "In the present context, the Tribunal's review may properly be more intense
19 than it would be if issues of policy or politics were involved."

20 I do not think that is a controversial proposition.

21 THE CHAIRMAN: That seems to be a proposition coming out what I am calling *Wednesbury*,
22 ordinary domestic judicial review analysis. Of course *Tameside* clearly was such.

23 MR. GREEN: It is common ground that ordinary principles of judicial review apply. We are
24 simply saying in the present case we are at the more intense end of the scale than the less
25 intense of the scale.

26 THE CHAIRMAN: But the addition of Article 1 of Protocol 1 does not make a significant
27 difference in and of itself, it is the context.

28 MR. GREEN: If the Tribunal accepts that we are at the more intense end of the scale then it may
29 well be that A1/P1 does not add materially, though we have relied in our skeleton at para.20
30 on the well known case of *ex parte Smith* in relation to A1/P1, which makes the point that
31 the court will not, for example, be inclined to overlook some perhaps minor flaw in the
32 decision making process, close scrutiny must be given to the reasons provided for the
33 interference with the right. The court's approach involves a more intensive review process

1 and a greater readiness to intervene than would ordinarily characterise a judicial review
2 challenge. That is para.20(2) of our reply and skeleton, we have cited *ex parte Smith*.

3 THE CHAIRMAN: Let me just look at that. That is the domestic *ex parte Smith*, which is again
4 *Wednesbury*.

5 MR. GREEN: It is a more intensive review.

6 THE CHAIRMAN: That does not seem to be a submission that Article 1 of Protocol 1 adds to
7 what you get from *Wednesbury*. Do I take it that you say it is the flexible *Wednesbury*
8 standard, you say a more intensive end of review, but you do not have a separate submission
9 that Article 1 of Protocol 1 makes a significant difference?

10 MR. GREEN: Our submission is that since it is A1/P1, it is more intensive than *Wednesbury*. In
11 practical terms, if applying the more intensive *Wednesbury* approach leads to the same
12 result then so be it, but in so far as there is any doubt we do say that it is an A1/P1 case and
13 does justify the more intensive form of review.

14 THE CHAIRMAN: Thank you.

15 MR. GREEN: I would like now to turn to Mr. Beard's submissions in relation to ground one, and
16 I am going to take them under some discrete headings. First of all, the submission he made
17 about the meaning of capacity. He said that government policy had not changed so
18 radically – and this was in response to an observation about para.10.117 – because the
19 government policy concerned only runways and not other forms of capacity. He said, and I
20 am summarising his submission, I hope not unfairly, that absent new runways there is still
21 competition for this other form of capacity. I hope it was clear from our submissions that
22 we have never limited capacity to merely runways in the submission I made about how
23 competition would unravel concerns – terminals, roads, and parking, and so on. We do
24 submit that the Commission itself assumes, and we submit correctly, that the driver for
25 competition has to be runway capacity. As Mr. Beard was making his submissions I was
26 noting a number of paragraphs in the 2009 report which we submit makes that clear. I
27 wonder if I can just give you a list of them. I am happy to take you to them, but given the
28 time it may be that you can verify them for yourself. The ones that I had picked up are as
29 follows: paras.18, 19, 5.16(c), (d), (e) and (f), 5.25, 5.29, 5.31 and 5.32.

30 It seems to us that, as a matter of common sense, our submission must be correct because it
31 is runway capacity which must drive competition. It is certainly true that you can build out
32 your other infrastructure or indeed redevelop it, as with T2, but you can only do so until you
33 meet the natural limit reflected by the number and scale of aeroplanes coming in and out of

1 the runways. So runway capacity is the dog. The associated infrastructure must be the tail
2 which responds to the dog.

3 The premise of 2009 was that there would be a steady increase in demand and new
4 runways, and everything would flow from that. We submit it is a really a matter of
5 common sense, although we absolutely accept, and I made my submissions on this basis,
6 that there is some scope for competition away from the runway – for example, terminals,
7 and so on. I think I referred to the fact that T2 is in the process of being redeveloped and
8 that is a form of capacity competition.

9 It does mean, again as a matter of common sense that there is a limit to the other form of
10 capacity based competition that can occur without a runway, and the inference which the
11 Commission introduced into para.10.117, when it referred to a “radical change of policy”, it
12 must be primarily concerned with runways.

13 The next point concerns the relevance of inter-airport exposure, which Mr. Beard spent
14 probably 40 minutes on this morning. With respect to him, it is an irrelevance. The starting
15 point for my submission was an acceptance of the conclusions contained in the inter-airport
16 exposure.

17 THE CHAIRMAN: What are we talking about now, is this chapter 3 of the 2009 report?

18 MR. GREEN: This is chapter 3, and there is one paragraph which I think makes the point very
19 neatly, which my friend alluded to but did not take you to, 3.168. Mr. Beard analysed 3.134
20 and he said that is where you find the conclusions, but 3.168 is the “Overall conclusion”.

21 THE CHAIRMAN: I think he did invite us to read that.

22 MR. GREEN: He did indeed invite you to read it, but he concentrated on 3.134. It is a very
23 important paragraph because it makes the point that we wish to make. It says:

24 “The analysis in this section has considered the substitutability of the BAA
25 airports and non-BAA neighbouring airports for one another in two broad
26 geographic regions – Scotland and the South-East. Overall we consider this
27 evidence to suggest that the BAA airports are the closest demand substitutes for
28 one another.”

29 That is the inter-airport exposure, and we have no quibble with that whatsoever.

30 “However, we recognise that there may be external constraints that impact on
31 the potential for competition ...”

32 and then the critical words –

33 “... even for very close demand substitutes.”

1 So Heathrow and Stansted and Gatwick may be very close demand substitutes because of
2 inter-airport exposure, but extraneous factors, such as capacity, impact on the potential for
3 competition, and they refer in particular to the existence of capacity constraints:

4 “As a result, we look at the issue of capacity constraints in Section 4 and then
5 consider the potential for competition between the BAA airports in the presence
6 of capacity constraints and price cap regulation in Section 5.”

7 So let us assume for the sake of argument, and it was very important for the 2009 analysis,
8 that the inter-airport exposure analysis demonstrated that the three airports were close
9 substitutes and they used the words “very close demand substitutes”. As new capacity
10 comes on stream, that fact, that analysis, will be very, very empirical support for their
11 conclusion that there would be a great deal of competition in the future because the only
12 curb on the ability to exploit those close demand substitutes was capacity. That shackle has
13 now been taken off. It was a critical part of the 2009 reasoning. Of course, if the capacity
14 constraint remains, then the clear inference of para.3.168 is that there remains a real
15 constraint on the potential for competition.

16 In that regard my friend took you to the evidence that they had relied upon to examine what
17 was then of course a capacity constraint position in 2009, and he said that some of the
18 evidence had not really been relied upon by the CC, the airline evidence, the price
19 substitutability evidence. One of the reasons ----

20 THE CHAIRMAN: I do not remember him saying that they had not been relied upon.

21 MR. GREEN: That probably is putting it too highly. He said that they had given less weight to
22 it. I think his submission was that it perhaps was not quite as important as we submit it is.
23 We submit this is the only evidence they refer to. Let me put my submission rather than his.
24 This is the only evidence they refer to. I took you through it at length to show you that
25 there is virtually no evidence suggesting material exchanges between Stansted and
26 Heathrow. The vast majority of the evidence concerns Gatwick or Stansted and Luton, or
27 Stansted and Gatwick. You can obviously form a view as to the bits of evidence I did refer
28 you to which does show some exchanges between Stansted and Heathrow.

29 He did not take you to what is the conclusion of that in para.3.129 through to 3.133. That is
30 the conclusion of the analysis of the evidence. I concentrated – and I am sure you will see
31 from your notes - on these paragraphs. Can I just make my submissions, not by re-reading
32 them, but by telling you the points I deduced from them. First of all, para.3.129, that is the
33 Commission’s conclusion that any constraint imposed by Heathrow on Stansted is weak. I

1 emphasised the words “it is very difficult for airlines to switch from Heathrow to other
2 airports”.

3 Then 3.130, even in the absence of BAA’s common ownership Heathrow has substantial
4 market power as a result of the difficulty in switching services to other airports, network
5 effects and locational advantages. They are all quite independently operating of the inter-
6 airport exposure analysis.

7 Then, we consider Heathrow is likely to retain the market power for a considerable period,
8 even if other London airports are under separate ownership.

9 That is one position, that is Stansted constraining Heathrow. You will see that they make
10 no finding whatsoever about the ability for passengers in that asymmetric line of attack to
11 exert any pressure. The reference to passenger pressure comes in the next section, which is
12 Heathrow as a constraint on Stansted from 3.131 on. They say there is a potential in 3.131,
13 and they then identify how the potential might arise in relation to LCC operators, and they
14 refer to the three potential forms of passenger pressure, namely they do not travel at all, they
15 switch to another airport, they go by car, and so on. They do not, in that section, analyse the
16 actuality behind the potential. They simply identify it as a potential. That is the only place
17 where they actually consider the scope for potential for passengers to exert any pressure.
18 Those are paragraphs we heavily rely upon. We rely upon 3.168. We take absolutely on
19 the chin everything Mr. Beard says about inter-airport exposure. We accept that the airports
20 are very close demand substitutes, as that term was understood in that part of the analysis,
21 but one is left with the Commission’s conclusions that there is a degree of asymmetry.
22 Heathrow is largely immune. There is a greater potential the other way round, but there is
23 no evidence that it is, in fact, strong, and there is certainly nothing in chapter 3 that says it is
24 strong. That is relevant, we say, to the analysis overall, because that being so one has to ask
25 the question in the proportionality test: how is it that severing Stansted will mechanistically
26 or causally create a materially large pressure on Heathrow to generate all the benefits? It is
27 a question really of causality, and the materiality of that causality.

28 The next point that Mr. Beard made that I would like to address concerns regulation. My
29 learned friend said that the Commission had investigated regulation and found it to be
30 inadequate. We have never made a submission that they did not investigate regulation. Our
31 submission is a quite different one. It is that we do not accept that regulation is wildly
32 inefficient, it does a good job, we do not say that it is perfect. Certainly we accept that the
33 Commission has made criticisms of the regulatory system, but in relation to the sorts of
34 matters that the Commission has identified as relevant in their own analysis of this issue, it

1 has done a pretty good job, in relation to price, service, capex and opex. We do not have a
2 submission that they did not investigate the matter. Our submission is different. It is,
3 having investigated and having concluded in relation to the key issues that it is a remedy
4 that can be targeted, that the evidence is that it can be effective, that it can be adapted over
5 time, the points we have set out in our speaking note and I referred you to. What was
6 incumbent upon the Commission to do and to perform was some assessment of the extent to
7 which there was deficit beyond regulation.

8 That was the key criticism we make of the analysis in this case. Unless you have an idea of
9 (a) is there a scope; and (b) its extent, you then do not know how effective the remedy is
10 going to be in achieving the benefit. As I emphasised yesterday, divestiture of Stansted is
11 the third pressure point to generate the benefits after regulation and the existing pressure
12 from Gatwick.

13 It is common ground between us that there are incremental benefits, but since that is all
14 there is to justify divestiture, that was something we submit required a very much more
15 intensive analysis in the more intensive form of judicial review.

16 The next point made by Mr. Beard concerned service quality. Again, we absolutely accept,
17 and I have never made the submission, that the CC did not examine service quality in the
18 2009 report – it would have been foolish to make that submission because it is there in
19 black and white. The SQR regime at Stansted was introduced in 2009, which was, I think,
20 the month after the report came out. So the 2009 report could not consider the impact of the
21 SQR regime.

22 There is some evidence which my friend referred you to improvements at Stansted. He
23 referred to table 7.3, but of course this was prior to the SQR. The question is, what is the
24 impact in 2011 of the divestiture of Stansted on service? We have relied already upon the
25 Commission's acknowledgement reflected in the 2009 and 2011 reports – just for your note,
26 para.19 of 5.1, where the Commission accepts that there is no necessary incentive on
27 management to do better, to spend money over and above that to meet the SQRs. There is
28 no analysis in 2009 or in 2011 of the SQR regime or how effective it has been. What we
29 say is as follows, simply this: the CC has not considered the gap at Stansted between
30 regulation and what competition through divestiture might bring about. We say that the
31 evidence of Gatwick is not conclusive. If Stansted's performance under the SQR post-dated
32 the report, and if the Commission had looked at that performance and examined it to see
33 whether or not it was, in fact, improved and the incentives were strong, it could then have
34 looked at the performance at Gatwick and said, "Gatwick's performance post-common

1 ownership has improved, but maybe no more than Stansted's has improved under common
2 ownership". It would have been the perfect foil by which to test the question of causality.
3 If the conclusion to that analysis had been there is not, in fact, any material difference, you
4 cannot then say it is common ownership which necessarily provides the clue to the answer.

5 THE CHAIRMAN: BAA had all that information. Did they put that to the Competition
6 Commission in either the first round of consultation after the Court of Appeal decision or
7 the second round of consultation on the provisional report?

8 MR. GREEN: Can I just take instructions on that?

9 THE CHAIRMAN: We have not been shown anything to suggest they did, so at the moment my
10 understanding is that they did not.

11 MR. GREEN: Can I proceed on the basis that we did not unless I get contrary instructions.

12 THE CHAIRMAN: Is that not quite damaging to your case because one would have expected, if
13 there was a happy story to tell about Stansted doing wonderfully well with SQRs, BAA
14 would have said that.

15 MR. GREEN: If you will recollect from the SQR regime, Stansted had to report to the CAA on a
16 regular basis.

17 THE CHAIRMAN: Sorry, my point was that one would have expected BAA, if they had a good
18 point on what was happening at Stansted in relation to compliance with the SQR regime, to
19 make that point forcefully in support of their case that regulation actually is a sufficient way
20 of dealing with the problem.

21 MR. GREEN: I take the point, Sir, I will take instructions.

22 THE CHAIRMAN: You take our point, you can see the force in the point, you are going to check
23 to see whether there is a factual answer – is that a fair summary of what you have just said?

24 MR. GREEN: I understand the point. One answer of course is that all investigations by the CC
25 are very much two way traffic. The Competition Commission, if it decides to investigate
26 something, in large measure it directs the nature of the investigation. That does not prevent
27 those subject to an investigation putting in evidence, but it is very much a CC led exercise.
28 They will tell people, they will issue questionnaires, issue papers, and so on, as to what they
29 want to hear about.

30 THE CHAIRMAN: Yes, I see, thank you.

31 MR. GREEN: Concerning capital expenditure, the question which the CC did not address itself
32 to was how would divestiture of Stansted discipline Heathrow, given the Commission's
33 conclusion that Stansted has very little ability to pressurise Heathrow, as set out in
34 para.3.129, and indeed the other way round. There is, hence, a contradiction between

1 para.3.129 and the 2011 report at para.62, where there was a suggestion that competition
2 could provide a major spur to capex efficiency. That is essentially the point we made to
3 you, which is that when the Commission simply says the benefits of competition are not
4 confined to Stansted, but would extend to the capital expenditure programme of both
5 Heathrow and Gatwick, we are entitled to say that in view of their prior findings, in fact,
6 those competitive pressures are very weak. That is not a self-evident proposition. It was
7 certainly open to the CC to reinvestigate the matter and come to a different conclusion on
8 the basis of evidence, but simply to assert that competition in view of its prior findings is
9 going to produce significant and substantial benefits is not self-evident and it is, in fact,
10 inconsistent with its prior findings.

11 THE CHAIRMAN: At 3.132 and 3.133 the Competition Commission concluded that there is
12 scope for competition.

13 MR. GREEN: Of course, as they say in 3.124 or 3.125, they have not measured it in that section.
14 It is just simply that they identify a potential which they then say they go on to measure in
15 section 5. So far as I can see, in section 5 there is no measurement of quantification of that
16 scope. This is a theoretical identification of potential. That is why their overall conclusion
17 in 3.168 is important.

18 THE CHAIRMAN: Yes, thank you.

19 MR. GREEN: As to para.7.16 of the 2009 report where they Commission make a number of
20 critical submissions about capex, again we have not disputed that the Commission has made
21 critical points about capex. Our submission in relation to this is that this was addressed in
22 2008. No further analysis was conducted. The 2009 report is simply cross-referring to
23 2008, because they were near contemporaneous in time. One followed on almost
24 sequentially from the other. So the Commission did not consider that it had to do a detailed
25 update. It had really the most up to date information that was necessary. Therefore, the
26 same question arises, whether, with an updated regulatory regime, there is daylight. I took
27 you to the nature of the regime, and again, just for your note, I was not going to take you
28 back to this, it is the 2008 report, 8.102 to 8.103, which is bundle D, tab 2, p.80.

29 THE CHAIRMAN: Is the 2008 report what have been calling Q5?

30 MR. GREEN: That is right, Q5, yes. There were three intrusive measures which were imposed
31 upon BAA.

32 THE CHAIRMAN: Sorry, what was the reference in the 2008 report?

33 MR. GREEN: It was 8.102 and 8.103, which summarises the measures the CC and the CAA took
34 in relation to capex. First of all, they remedied the defect which they identified by imposing

1 a capex limit of 6 per cent. They had a detailed requirement for new processes for further
2 capital expenditure evaluation and then quantitative reporting to the CAA. So a very new
3 and intrusive regime was in place. It was not re-examined in 2009, it was not re-examined
4 in 2011. Given chapter 3, the limitations we say on scope for competition from Stansted,
5 given the improved and enhanced regulatory regime, we again say it is not intuitive or
6 consistent with their own prior findings to assume there was a material gap which even
7 individually or cumulatively warrants the draconian remedy of divestiture.

8 Opex, Mr. Beard said that the advantages referred to were merely illustrative, they had
9 taken them from the 2009 report. He referred to absenteeism and pay. It is correct that they
10 are referred to as illustrative in the 2009 report, but in relation to the 2011 report you will
11 recollect that the only evidence that the Commission had, and they did look around for
12 updating evidence, was that under the opex regime Stansted had an incentive to exceed
13 efficiency saving – in other words, there was an incentive to do better – that is para.70.
14 They then identified IT related costs which they discussed with Gatwick, but they
15 acknowledged that BAA’s extant proposals might actually just replicate what Gatwick is
16 doing. That is para.71. Then they just leap to the conclusion, and it is a leap in logic and
17 faith – that competition from independent ownership of the London airports would create
18 commercial pressures on airport operators to review expenditure and reduce costs. In view
19 of their finding about the commercial incentives created by the opex regimes in para.70, that
20 is inconsistent with their prior finding and counter-intuitive.

21 Comparative competition, Mr. Beard effectively said that it was all so obvious one did not
22 need to address it. I am not going to therefore repeat what I have said already. We have set
23 out our position in the speaking note, and we have identified all of the ways in which the
24 Commission acknowledged the limitations of that comparative exercise.

25 In relation to price, my learned friend quite rightly said that all the Commission had done
26 was to say these were modest benefits. He then identified that all they needed was a very
27 modest benefit to overcome the pro rata maximum divestiture cost. This raises a very basic
28 proportionality point. If the benefits are much reduced compared to the previous decision
29 and the costs of divestiture are small, it is not an equation which ought to tell one whether a
30 regulator is entitled to order a draconian remedy. Simply because you can do it, and
31 because the benefits minimally outweigh the costs, it should lead a regulator to exercise a
32 high degree of self-restraint. You should not interfere in the market unless you have a very
33 strong quantified benefit for doing so. On their analysis, if you have got a small quantified
34 benefit, but the cost of separation is very limited, then you can order divestiture; it is

1 proportionate. We would submit the legitimate aim in condition one must be an overall
2 holistic view of scale. If the quantified benefits are small and, yes, they exceed by even a
3 reasonable margin the cost, that should not ever be a reason why a governmental agency
4 should interfere in somebody else's business. A legitimate aim should take into account the
5 overall scale between of the benefit and the relationship between cost and benefit.

6 So simply to say all we need to do is show a small benefit in any of these things, and even a
7 small benefit times 30 becomes slightly larger, it should not, in the first instance be a reason
8 for ordering a draconian remedy.

9 MR. ALLAN: So you are putting that within the statutory framework, and you would simply
10 bring that within the concept of reasonableness?

11 MR. GREEN: And I think it would go into the review of what is a legitimate aim in condition
12 one of the proportionality test. I think those four conditions are the way in which the
13 Tribunal has interpreted the statutory framework, so it is the same thing, yes.

14 Can I move now to ground 2? I am going to deal with this very briefly. I am not going to
15 repeat the points I have made already. The point comes down to this: Mr. Beard made the
16 submission that the disavowal in para. 111 about reliance upon extra spare capacity can be
17 read consistently with paragraph 285. Well, assume that it can, it does not tell you anything
18 about the relevance of the other paragraph we relied upon as the primary paragraph, 114,
19 and 114 we submit is a conclusion. It is a finding, but it is common ground that it is
20 irrelevant. If you conclude that it is simply an oversight then so be it, but we submit it is not
21 an oversight, it is one of three paragraphs under a heading "Conclusions" and it seems to us,
22 as a matter of reading the report, it is something they have taken into account. That is all I
23 wish to say about ground 2.

24 Ground 3, which is profitability at Stansted – again, if you would like me to I can take you
25 to references, but otherwise I am just going to give you references and they can of course be
26 verified later.

27 THE CHAIRMAN: You will have to do that because we need to complete by five past five at the
28 latest.

29 MR. GREEN: Gladly. Ground 3, the Commission accepts it adopted a 'very simple' – those
30 were Mr. Beard's words – and a broad analysis of profitability ----

31 THE CHAIRMAN: Strictly they were the words of the Competition Commission.

32 MR. GREEN: Absolutely, on behalf of the Commission.

33 THE CHAIRMAN: In the report.

1 MR. GREEN: In the report, yes. We have submitted, and again I will just give you the
2 references: notice of application, paras. 91 to 97, reply and skeleton paras. 125 to 129 and
3 the annex, speaking note at 264 to 286, but this issue goes to whether there should be a
4 divestiture remedy – and that was the position we advanced to the Commission, and also the
5 nature of the remedy if one is in fact ordered.

6 The Commission has accepted in its defence at para.90 and, in particular, footnotes 47 and
7 48 on p.36, bundle E:

8 “Producing a disaggregated profitability analysis of the performance of comparator
9 airport groups would in fact be impracticable because of the lack of information
10 generally available in the public domain from which to perform such an analysis,
11 and also because of differences in segmentation definitions used by different
12 airport groups.

13 Airport operation generates a variety of income streams (e.g. aeronautical income,
14 retail activities, property rental, services, etc). The relative composition of these
15 income streams will vary from airport to airport depending on configuration of the
16 airport and management decisions.”

17 And they accept that there is effectively a very limited practicability from doing any form of
18 comparative analysis of accounts of foreign airports. Having said that, since they
19 effectively concede that it is an impracticable and non-indicative exercise, that is the only
20 piece of evidence they have relied upon, even as they describe it as a ‘sanity test’ to decide
21 whether or not Stansted’s profitability is, in fact, relatively superior.

22 Our submission, and again the reference is to what we said and you have seen it already,
23 bundle B, tab 10, para.9, which is important because we said that we do not have the time to
24 conduct an analysis but we need to work with you to conduct a full analysis.

25 At paras. 64 to 75 and 109 to 111, BAA advance the submission that relative performances
26 were inappropriate but BAA’s performance was inferior at Stansted. The CC rejected the
27 submission and they concluded that it is an irrelevance. They have not, however,
28 challenged our analysis in our reply in response to their paragraph 90 of the defence. They
29 have not challenged or disagreed with our analysis in the Annex of the different ways in
30 which the details of those accounts they have relied upon lead to potentially different
31 results, so one is left with this, that they conducted an analysis based upon an approach they
32 accept is impracticable and unworkable. They have not challenged our factual analysis of
33 the documents they have relied upon, which we did in order to respond to the criticisms
34 they made of us in the defence. It is an important factor, it might have led to a different

1 remedy to divestiture, for example, stand alone, or a recommendation that there be a re-
2 review of this issue in three years or five years by the Office of Fair Trading, with the
3 possibility of another review back.

4 It could have profoundly affected timing. They could have said “divestiture within five
5 years; holdseparate during that period.” There were many permutations of what might have
6 happened, and we submit that, having accepted, they conducted a review on an inadequate
7 basis – that is a judicial review ground.

8 Finally, ground 4 – can I just clarify, it is not our submission that the approach the CC
9 adopted would lead to a fire sale. We submit they have made an error of law; I hope that
10 was clear and I think the Tribunal understood my submission to be that.

11 THE CHAIRMAN: Yes.

12 MR. GREEN: Our submission is that as a matter of law they have misdirected themselves
13 because the Tribunal did not limit the loss to that of a fire sale. The Tribunal accepted, on
14 the basis of submissions made to it, that there was a difference in value over time, which is
15 a proposition no longer accepted, not just the market value you get in an orderly sale, X
16 months, but there was a different in value because it might impact upon the number of
17 purchasers who bid, capital adequacy – the availability of capital – and so on. So, for
18 example, there may be a difference in value that a vendor could get by being required to sell
19 in five years or seven, or by some other means. We submit that that is what the Tribunal in
20 2009 understood and is what they ruled upon, and ultimately this comes down to a question
21 of construction of the Tribunal’s Judgment.

22 Mr. Beard’s position now seems to be that the Tribunal concluded that all they had to avoid
23 was a fire sale loss and I have made my position clear, we are not submitting that. We
24 submit, on a proper analysis of the Tribunal’s Judgment the Tribunal was requiring the CC
25 to identify what we describe as a ‘counterfactual loss’, which is simply what BAA has given
26 up by virtue of the remedy and had accepted as a fact that this analysis had, in fact, been
27 done. You asked Mr. Beard why we had not appealed this, it is because we believed the
28 Tribunal’s Judgment had been one of fact. They had concluded that there had been an
29 elimination of all loss and it was not open to us therefore to analyse fact.

30 In this regard, the final point and perhaps one of very considerable significance is the
31 Treasury Solicitor’s letter. We specifically asked whether they had conducted a qualitative
32 analysis in 2009, that was the most important part of the question we asked and they said
33 “no”. That was, we submit, quite the opposite of what was submitted to the Tribunal. We
34 made it very clear why we asked that question: “In 2009 did you conduct a qualitative

1 analysis?" and they said "No". That was not what the Tribunal understood the position to
2 be, and that is why the theory advanced now was not the theory put to the Tribunal. It was
3 not there cannot be a loss provided you have an orderly sale. That was not the argument put
4 to the Tribunal, it was not what the Tribunal understood the position to be.

5 Those are my submissions.

6 THE CHAIRMAN: Thank you very much. Our thanks to all counsel. We will reserve our
7 Judgment.

8
