



House of Commons
Transport Committee

The future of BAA

Fourth Report of Session 2007–08

Report, together with formal minutes, oral and written evidence

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The Transport Committee

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1 Introduction

Our inquiry

1. BAA Limited (BAA) owns and operates seven of the UK's airports at Heathrow, Gatwick, Stansted, Southampton, Glasgow, Edinburgh and Aberdeen. Its dominant market position has for some time led to calls for it to be broken up, both by the airlines and this Committee. In March 2007, the Office of Fair Trading instructed the Competition Commission to investigate whether BAA's market position was limiting competition in the UK aviation sector.

2. In October 2007, we announced our own inquiry into the future of BAA. We explained our reasons for holding an inquiry thus:

BAA airports are a vital part of the country's transport infrastructure, serving nearly 150 million passengers each year between them. The company is facing a number of unique challenges in addition to those faced by the aviation sector as a whole. We want to find out how the company, the government and other stakeholders will respond to the current situation.¹

3. We particularly wanted to consider:

- the regulatory framework;
- the quality of service provided;
- the size and quality of investment;
- any consequences following from the acquisition of BAA by Ferrovial;
- the implications of further runway and terminal capacity; and
- how more competition could be introduced into the market.

4. In response to our call for evidence, we received written memoranda from 30 organisations and individuals. As well as BAA, we invited the regulators, unions, airlines and the Department for Transport to give oral evidence. A full list of witnesses is provided on page 41.

5. Our inquiry has taken place over a period in which BAA has rarely been out of the headlines. The publication by the Civil Aviation Authority's (CAA) of its final price control proposals on 20 November came the day before representatives from the regulator gave evidence to the Committee. The *Financial Times* reported the claim made by airlines that the rise in fees represented a "reward for failure".² Meanwhile, *The Guardian* reported that the reduction in the return on capital investment from 7.75% to 6.2% at Heathrow and

1 'The future of BAA', Transport Committee press release, Press Notice 57 Session 2006–07, 17 October 2007

2 'Prospect of higher fares as Heathrow charges rise 15%', *The Financial Times*, 21 November 2007, p 3

6.5% at Gatwick that BAA's owners Ferrovial would receive meant that under the CAA's proposals the refinancing was "thrown into doubt".³ This has been disputed by BAA.⁴

6. In November, the Secretary of State for Transport (Rt Hon Ruth Kelly MP) announced a public consultation on the construction of a third runway and sixth terminal at Heathrow airport.⁵ The consultation document, *Adding capacity at Heathrow airport*, invites members of the public to comment on the Government's proposals.

7. In December, members of the Unite union threatened strike action over the proposed closure of the final salary pension scheme to new employees. This brought adverse publicity over the Christmas and New Year period, with media predictions of delays and the possible closure of BAA's seven UK airports. In January, the strikes were averted after discussions between BAA and the union.⁶ Also in December unusually poor weather on a significant number of days led to cancellations and delays and brought even more adverse publicity.

8. On 27 February, BAA announced that Colin Matthews—formerly Chief Executive of Severn Trent plc and Director of Technical Operations at British Airways—would replace Stephen Nelson as Chief Executive from April. In a press release BAA's Chairman, Sir Nigel Rudd, said that BAA was entering a new era in which "new demands for quality service and environmental responsibility" needed to be met. He explained that Mr Matthews had "the right background and experience to take BAA into that new era".⁷

3 'BAA told to cut queues or face £75m fine', *The Guardian*, 21 November 2007, p 27

4 Q 245

5 'Public invited to have their say on the future of Heathrow', Department for Transport press release PN-166, 22 November 2007

6 'Air chaos threat recedes after negotiations', *The Guardian*, 1 January 2008, p 6

7 BAA, 'BAA has announced a change of Chief Executive to take effect from 1 April 2008', 27 February 2008, www.baa.com

2 Background

History of BAA

9. The British Airports Authority was established under the *Airports Authority Act 1966*, and was initially responsible for the airports at Heathrow, Gatwick, Stansted and Prestwick. In the early 1970s, the authority acquired Edinburgh, Aberdeen and Glasgow airports. Twenty years after the first act, the *Airports Act 1986* was passed, which turned the British Airways Authority into the holding company BAA plc.⁸ BAA was privatised in 1987, and over the course of the 1990s sold Prestwick and acquired Southampton airport. Figures from the CAA show that BAA airports accounted for 53% of all commercial air transport movements nationally, and 85% of movements in the London area in 2006.⁹ The future of BAA is therefore of central importance to the United Kingdom's transport infrastructure.

Takeover by Ferrovial

10. In March 2006, BAA were approached by a consortium led by Ferrovial, an international construction group with a major interest in transport infrastructure.¹⁰ The first formal offer made by Ferrovial in April 2006 for 810 pence per share was rejected. A second offer of 900 pence was made and rejected in May. Following negotiations between the board of BAA and Ferrovial, an offer of 950.25 pence per share was made by Ferrovial on 12 June and recommended to shareholders by the BAA board four days later.

11. On 26 June 2006, the Ferrovial Consortium announced that it had received acceptances with regard to 83% of BAA's issued shares, and took control of BAA plc. Once 90% of the issued shares had been acquired on 15 August, BAA plc was delisted from the London Stock Exchange.

Debt and refinancing

12. Ferrovial's final price of 950.25 pence per share (935 pence per ordinary share plus a 15.25 pence dividend) was a 17% increase on its original offer, and 49% above the share price prior to the takeover approaches becoming public.¹¹ The sale price valued BAA at £10.11bn. BAA needs to refinance the debt that was placed on it by the acquisition and is expected to do so once the regulatory settlement is finalised in March 2008. An article in the *Financial Times* described how BAA plans to refinance its existing debt against Heathrow and Gatwick, as well as borrowing against the value of those two airports. It went on to speculate that:

The numbers, however, look worrying. Earnings before interest, tax, depreciation and amortisation in 2008 are estimated at £1.2bn, rising to £1.3bn by 2010. This is

8 The apparent acronym has only historical meaning—'BAA' does not, strictly speaking, stand for anything.

9 CAA, UK Airport Statistics 2006 (Annual), Table 3 (Aircraft Movements), www.caa.co.uk/airportstatistics (latest figures available).

10 Airport Development and Investment Ltd. was formed by Ferrovial Infraestructuras, S.A., Caisse de dépôt et placement du Québec and GIC Special Investments PTE Ltd for the purpose of acquiring BAA.

11 BAA, 'Recommended final offers document', Acquisition History, 12 June 2006, www.baa.com

not enough to fund interest costs, which should be in the order of £800m annually, as well as capex [capital expenditure], which Collins Stewart [a financial services group] estimates at an annual £1.4bn for the next five years. So, either borrowing will rise significantly more or BAA's capital structure will have to change.¹²

13. The plans for refinancing are being delayed until March because they depend in part upon the CAA's decision on the level of charges that BAA will be able to make to the airlines. When we questioned BAA's Chairman, Sir Nigel Rudd, about the rate of return that Ferrovial will see on their investment, based on the level of charges proposed by the CAA on 21 November, he said that Ferrovial "have been genuinely surprised and shocked by the reduction [of the estimate of the cost of capital at Heathrow] from 7.75 per cent to 6.2 per cent in the present review."¹³ Stephen Nelson, BAA's Chief Executive, explained that:

We would imagine that actually the risks of operating and building out a runway, and indeed an airport of the kind of Heathrow, are going up rather than down, but what that settlement indicates is that the risks have gone substantially down, and we do not accept that.¹⁴

14. Ferrovial acquired BAA with the expectation that it would make a worthwhile return on its investment. The premium it paid, the reduction in the CAA's estimate of the cost of capital affecting the price settlement up to 2013, and the uncertainty resulting from that combination has led to speculation that the amount that could be borrowed against the airports will reduce. When we asked Sir Nigel Rudd what he thought had gone wrong, he told us that Ferrovial "had that advice and the advice was clearly wrong, because the rate which has been offered is far lower than that advice".¹⁵ The level of charges, and the process by which they are set, is discussed in more detail in Chapter 3.

Other inquiries

Our previous inquiries

15. In recent years, we and our predecessor committee have held inquiries into Aviation,¹⁶ the Work of the Civil Aviation Authority¹⁷ and Passengers' Experiences of Air Travel.¹⁸ Our opinion of BAA's position in the UK aviation sector has been consistent, as has our proposal for a remedy. Our predecessor committee wrote in 2003 that "it is ineffective and inappropriate to have a single private sector operator controlling such a large part of our aviation infrastructure [...] In our view it would be more appropriate to break up its monopoly".¹⁹ In our inquiry into the work of the CAA, we noted that "during the course of

12 'BAA finances', *Financial Times*, 9 November 2007, p 18

13 Q 281

14 Q 284

15 Q 286

16 Transport Committee, Sixth Report of Session 2002–03, *Aviation*, HC 454-I

17 Transport Committee, Thirteenth Report of Session 2005–06, *The Work of the Civil Aviation Authority*, HC 809

18 Transport Committee, Eighth Report of Session 2006–07, *Passengers' Experiences of Air Travel*, HC 435-I

19 Transport Committee, *Aviation*, HC 454-I, para 117

our inquiry, a number of witnesses again raised the monopoly issue [...] We remain of the opinion that the BAA monopoly should be broken up”.²⁰ Most recently, in our inquiry into passengers’ experiences of air travel, we “received little evidence pointing to benefits from BAA remaining in its present state and we see no reason to change the view of our predecessor Committees that BAA should be broken up”.²¹

16. Breaking up the BAA group of airports is one of two major options for change that we considered, the other being the possibility of competition between terminals. There is also competition from other international hubs.

The Competition Commission’s current market inquiry

17. On 29 March 2007 the Office for Fair Trading (OFT) made a reference to the Competition Commission for an investigation into the supply of airport services in the United Kingdom. Under section 131 of the Enterprise Act 2002, the OFT is able to make a reference to the Commission if it:

has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.²²

18. The main issues identified by the Competition Commission as relevant to their investigation are the regulatory framework, the common ownership of airports by BAA and the restrictions on development and capacity. These issues are central to our own inquiry, and while we hope that the Commission will take our conclusions and recommendations into account, we do not believe our report will prejudice whatever conclusions it may come to. As at February 2008, the Commission hoped to publish its emerging thinking in around April 2008, with provisional findings and remedies following in August 2008 and a final report to be made in December 2008.

20 Transport Committee, *The Work of the Civil Aviation Authority*, HC 809, para 142

21 Transport Committee, *Passengers’ Experiences of Air Travel*, HC 435-I, para 64

22 Enterprise Act 2002, section 131

3 Regulation

The regulatory framework

Economic regulation of the aviation industry

19. The CAA is the independent regulator for civil aviation in the UK. Set up in 1972, it is responsible for air safety, airspace regulation, economic regulation and the protection of consumers. In its role as economic regulator, it controls prices at four ‘designated’ airports: Heathrow, Gatwick, Stansted and Manchester.

20. Section 43 of the Airports Act 1986 requires the CAA to make a reference to the Competition Commission every five years, which is charged first, with recommending the level of airport charges that designated airports should be able to charge and second, investigating whether the airport operator has “pursued [...] a course of conduct which has operated or might be expected to operate against the public interest.”²³

21. In its report on *Aviation*, our predecessor committee wrote that:

We consider that a regulatory system in which two bodies do the same job twice, and wrangle over the extent of one another’s powers and responsibilities, must increase the costs of regulation. Still more significantly, it must act as a considerable barrier to a clear, coherent policy on aviation, which is essential for the future of the industry. The relationship between the CAA and the Competition Commission needs to be resolved.²⁴

22. In our report on *The Work of the Civil Aviation Authority*, we recommended that:

The Government implement its own 1998 proposals to make CAA airport review decisions subject to the standard regulatory model, in which the CAA reaches airport price control decisions based on its own review and the airports, as the regulated organisations, subsequently have the right of appeal to the Competition Commission.²⁵

23. A decade has passed since the Government made those proposals, and the relationship between the CAA and Competition Commission has not changed. When the subject arose in the present inquiry, Dr Harry Bush of the CAA agreed that the process of setting price controls was “over-complicated [...] with the best wishes to the Competition Commission the sooner we clear them out of the process the better.”²⁶ With the price controls for the next five years being almost set and the Competition Commission’s market inquiry, the opportunity to reform the process by which price controls are set has passed. Dr Bush from the CAA described the current state of affairs thus: “the Government has said that it will think about the regulatory issues that arise once the Competition Commission has finished

23 Airports Act 1986, section 43

24 Transport Committee, *Aviation*, para 115

25 Transport Committee, *The Work of the Civil Aviation Authority*, para 133

26 Q 15

its market inquiry because at that point it will know the market within which regulation is taking place”.²⁷

24. On 9 October 2007, the Secretary of State for Transport (Rt. Hon. Ruth Kelly MP) announced that Sir Joseph Pilling would lead a strategic review of the Civil Aviation Authority. The review will be “complementary to (but separate from) the Competition Commission enquiry into BAA, which may comment on CAA’s specific powers for the economic regulation of airports”.²⁸ It will take into account the conclusions of the Eddington report on the links between transport and economic productivity and the Stern review of the economics of climate change.²⁹

25. The Competition Commission should not automatically be involved in the review of airport charges. Instead, it should be a body to which the airport operators may go if they wish to appeal. We welcome the Government’s announcement of the strategic review of the CAA, and hope that Sir Joseph Pilling will take note of the consensus that has emerged around the question of the nature of the future relationship between the CAA and the Competition Commission.

Designation

26. Airports are designated for the purpose of economic regulation under section 40 of the Airports Act 1986. Airports are designated for the purpose of price control if any of the following criteria apply:

- the airport, either alone or together with any other airport(s) in common ownership or control, has or is likely to acquire, substantial market power; and
- domestic and EC competition law may not be sufficient to address the risk that, absent regulation, the airport would increase and sustain prices profitably above the competitive level or restrict output or quality below the competitive level; and
- designation under Section 40 of the Airports Act 1986 would, taking account of the magnitude of the risk identified in (2) and its detrimental effects were it to materialise, deliver additional benefits (i.e. over and above competition law) which exceed the costs and potential adverse effects of such designation (i.e. the incremental benefits are positive).³⁰

27. In our inquiry into the work of the Civil Aviation Authority, we recommended that “the Government should consider de-designating Manchester and Stansted”.³¹ The

27 Q 17

28 ‘Strategic review of the Civil Aviation Authority’, Department for Transport press release 2007/0139, 9 October 2007

29 Department for Transport, *The Eddington Transport Study*, December 2006. HM Treasury, *Stern Review: The Economics of Climate Change*, October 2006.

30 ‘Decision on proposed designation and de-designation criteria for airports’, Department for Transport press release 2008/004, 15 January 2008

31 Transport Committee, *The Work of the Civil Aviation Authority*, para 128

Government has completed its review of designation at Stansted and Manchester, and announced its decisions to de-designate Manchester but to leave the status of Stansted unchanged on 15 January 2008.³² The Secretary of State made her decision following advice from the CAA and public consultations, and a review by Professor Martin Cave of the Warwick Business School. She decided that Manchester should be de-designated on the grounds that it does not have significant market power. The decision to preserve Stansted's designated status was 'more finely balanced' than the decision on Manchester, but the Secretary of State decided that all three criteria for designation had been met.³³

28. However, in its evidence to the DfT's review, the CAA advised the DfT that Stansted did not hold a position of substantial market power, that existing regulation was sufficient and that continued designation would not deliver any additional benefits.³⁴ This was consistent with oral evidence given to us by Dr Harry Bush on 21 November 2007.³⁵ The DfT's decision to take the opposite view was based largely on supplementary consultation with the airlines, and was taken with an awareness of the fact that the circumstances of BAA's London airports may change after the Competition Commission completes its market inquiry.

29. We agree with the CAA that economic regulation should only apply where there is a need for it, and therefore welcome the Department's decision to de-designate Manchester airport. Although Stansted will remain a designated airport for the immediate future, we are confident that the circumstances of BAA's common ownership will change in the foreseeable future, either through the actions of the Competition Commission or BAA.

Charges

What is an airport charge?

30. There are two types of relevant charge under the Airports Act 1986. Section 36 of the Act defines 'airport charges' as:

- a) charges levied on operators of aircraft in connection with the landing, parking or taking off of aircraft at the airport (including charges that are to any extent determined by reference to the number of passengers on board the aircraft, but excluding charges payable by virtue of [section 73 of the Transport Act 2000 (charges for services) [and penalties payable by virtue of sections 38C and 78A of the Civil Aviation Act 1982]]); and
- b) charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air.³⁶

32 'Decision on proposed designation and de-designation criteria for airports', Department for Transport press release 2008/004, 15 January 2008

33 *ibid.*

34 CAA, *De-designation of Manchester and Stansted airports for price control regulation: the CAA's advice to the Secretary of State*, 10 November 2007, www.caa.co.uk

35 Q 25

36 Airports Act 1986, section 36

Fifth quinquennial review of charges

31. Airport charges are set over five year periods. At present we are in the fourth of these, and the CAA is currently consulting on the level of charges that will apply in the fifth quinquennium between 2008 and 2013. It published its final price control proposals on 20 November 2007, and is expected to publish its decisions in March 2008. It is possible that the CAA's estimate of the cost of capital will increase, given the uncertainty in the financial markets.

The basis of charges

32. Airport charges are reviewed on the grounds of providing for an appropriate level of new investment and a rate of return commensurate to the cost of capital necessary for such investment to be carried out.³⁷ The specific factors taken into consideration are:

Capital expenditure (capex)

Capex describes the expenditure required for the acquisition of a long-term asset.

Regulatory Asset Base (RAB)

The RAB is a proxy value of the airport's regulated operating assets, upon which the owners of the airports earn a return.

Cost of capital

The cost of capital is the weighted average of its two components: the cost of debt and the cost of equity.

Depreciation of assets

The rate at which assets reduce in value.

Operating expenditure (opex)

Opex is an airport's operating expenditure on the day-to-day running of business (e.g. for staff, utilities, day-to-day maintenance etc).

Other revenues

Other non-regulated income comes from retail sales, property and non-aeronautical revenues (mainly other charges to airlines).

Forecasts of traffic

The assumptions regarding numbers of passengers passing through the airport over the specified period.³⁸

37 Competition Commission, *BAA Ltd: A report into the economic regulation of the London airports companies (Heathrow Airport Ltd and Gatwick Airport Ltd)*, 28 September 2007, para 4.1

38 *ibid.*

Regulatory Asset Base regulation and 'gold-plating'

33. In both its written and oral evidence to the Committee, easyJet questioned the appropriateness of basing charges upon a regulatory asset base (RAB). In its written submission to the Committee, it argued that:

Regulatory Asset Base (RAB) regulation does not work well for large or lumpy investment, and dictates price paths that are inconsistent with those that would be expected in a competitive market. For example, under RAB regulation, prices charged by an airport increase significantly when new investment is undertaken, and then fall over time as passenger numbers increase. However in a competitive market, we would expect to see the reverse pattern.³⁹

34. In oral evidence to the Committee, Mr Nicol explained that in easyJet's view, RAB regulation enabled BAA to "spend and spend and spend and we [the airlines] are the ones who have to pick up the bill."⁴⁰ When we asked Mr Nicol what the alternative to RAB regulation would be, he argued that the only real solution would be to have someone other than BAA owning the new facilities.⁴¹

35. Whether anyone would want to take up such an opportunity is, in our view, doubtful. If BAA retained control of all the other airport facilities, such ownership would be very isolated and would not alter BAA's dominant position to any real extent. **The real problem in the airports sector is that there is a need for economic regulation at all. The fact that regulatory asset base regulation brings problems of its own is another issue entirely. Piecemeal ownership of terminals by companies other than BAA is not radical enough a solution to the problem of BAA's monopoly.**

36. The ability to "spend, spend, spend" leads, according to easyJet, to BAA over-investing in new facilities to maximise the value of its regulatory asset base:

The level of gold plating which we felt was going on at Stansted was just too high. It is a relatively small thing, but to give a cast iron example, the suitability of the infrastructure to take the A380. No Stansted operator operates anything like an A380. No airline that I can think of is going to put an A380 into Stansted in the coming decades, so why are we the users, particularly easyJet and Ryanair, going to be expected to pay for that?⁴²

37. The construction of a second runway at Stansted has now been overshadowed by the consultation on development at Heathrow. This point about accommodating the A380 arose in a recent Westminster Hall debate on that expansion. In the debate, it was argued that the advent of quieter aeroplanes such as the A380 might mean less local opposition on noise pollution grounds to airport expansion. The Government was urged to mandate lower noise levels from airlines and aeroplane manufacturers.⁴³

39 Ev 124, para 13

40 Q 172

41 Q 173

42 Q 174

43 HC Deb, 12 December 2007, col 116WH

38. The long-term business case for the A380 as a ‘superjumbo’ is predicated upon a healthy continuation of the ‘hub and spoke’ model of air travel. The point about Stansted is that it is not—and almost certainly never will be—a hub and spoke airport, so there is no point preparing it for an aeroplane that is designed with that purpose in mind. Other new aeroplanes will presumably be less polluting as the technology improves, but this is unlikely to show a benefit for many years.

Service quality and rebates

39. In our report on passengers’ experiences of air travel, we agreed with the CAA “that the [regulatory] regime could be further improved by introducing penalties for poor performance.”⁴⁴ A small proportion (4% at Heathrow and 3% at Gatwick) of revenue depends on these penalties. The final price control proposals published by the CAA on 20 November 2007 make 60% of Heathrow’s and 40% of Gatwick’s capital programmes for the next five years subject to rebates.⁴⁵

40. The quality of service provided by BAA was brought up by all of the airlines in their oral evidence. Dr Paul Ellis from British Airways said that “we have had poor service in respect of the management of security at the BAA airports in the most recent year or so.”⁴⁶ Don Langford of American Airlines said that “over the past few years BAA has actually been less responsive to operational issues.”⁴⁷ Mr Langford gave the example of getting flight crew through security control posts. He told us that there had been occasions when air crew had been held up because they were sitting behind deliveries of non-time critical supplies.⁴⁸

41. This is exactly the sort of problem that rebates are designed to avoid. When we put the point about prioritisation of crew at checkpoints to BAA, Mr Kyran Hanks (Economics and Regulation Director) pointed out that “as part of the next regulatory settlement there has been an agreement made with the airlines at both Heathrow and Gatwick to put a service quality incentive on the airports to minimise the queues at those control posts.”⁴⁹

42. Appendix C of the Civil Aviation Authority’s price control proposal document sets out ‘triggers’ for BAA to pay rebates to airlines in respect of poor service. Triggers set on capital projects, such as the refurbishment of Heathrow’s Terminals 1–4 and the construction of new facilities, ensure that money BAA receives from the fees it charges gets spent on the projects it has agreed with the regulators.

44 Transport Committee, *Passengers’ Experiences of Air Travel*, para 75

45 CAA, ‘CAA issues its price control proposals for Heathrow and Gatwick airports’, www.caa.org.uk, 20 November 2007

46 Q 149

47 Q 169

48 Q 150

49 Q 253

43. Service quality will be assessed in seven key areas:

- The availability of seats in departure lounges
- The cleanliness of terminal facilities
- The ease of way-finding
- The display of flight information
- The length of central security queues
- Passenger sensitive equipment
- The efficiency of baggage carousels in arrival areas

44. We pressed the CAA and Competition Commission on why they felt that BAA needed a programme of incentives to meet minimum standards of service quality. Mr Martin Stanley of the Competition Commission explained that “it would be a strange regulator [...] that says, ‘Here is the money that you can get for landing charges over the next five years but it does not matter what service quality.’”⁵⁰

45. It was, and remains, our view that BAA should be doing a lot of things covered by the incentives anyway. We have no issue with the principle of performance-related pay as applied through service quality rebates. We do, however, regret the apparent need for such targets. If there were no position of market power in the UK airports sector—if there was real competition for traffic—airport owners would not need incentives from an external regulator.

46. In its report on the economic regulation of the London airports, the Competition Commission stated that “the total amount of revenue at risk needs to be sufficiently large to incentivize BAA to maintain the agreed standards.”⁵¹ They “note that, in many anti-trust regimes, penalties for infringement may be equal to 10 per cent of an enterprise’s revenue and that this is considered an appropriate incentive to compliance.”⁵²

47. We believe that the percentage of revenue subject to rebates should be higher, as suggested by the Competition Commission. The comparison of the regulation of BAA to an anti-trust regime lends further weight to our view that BAA’s market position is fundamentally anti-competitive.

50 Q 22

51 *BAA Ltd: A report into the economic regulation of the London airports companies*, Appendix L, para 40

52 *ibid.*

4 Challenges

Competition

The need for competition

48. Both BAA and the trade unions asserted that common ownership of the London airports is a necessary condition of effective investment.⁵³ We disagree, and set out our reasons for doing so below. **We believe a competitive airports sector would be better than the current state of affairs, where in our opinion competition is stifled by common ownership of several major airports. Airports under separate ownership would have to compete for traffic. This would also have positive consequences for passengers. BAA's common ownership is holding back the natural development of the market, where discrete passenger markets are less well-defined.**

Potential competition

49. It is important to stress that competition in the airports sector is subject to several major limiting factors. When a competitive airports sector is referred to, it should be qualified by an awareness of these limitations. The problem is one of supply and demand. The demand for air transport is not evenly spread, or even all of the same type. There is more demand for capacity in the South East of England, and that demand can be split in several ways, short vs. long haul and business vs. leisure being the two most obvious. The problem with supply is also complicated in that different airports can also be categorised as (predominantly) serving different modes of transport. 'Hub-and-spoke' model works with large airports through which flights are directed, even if that airport is not the final destination. Over one third of Heathrow's traffic is 'hub-and-spoke', and it is thus referred to as a hub airport. In 'point-to-point' flying, the passenger boards a plane and flies directly to his final destination, which might be a large hub airport or a smaller regional airport. While it is possible to build a small airport capable of flying a modest number of point-to-point flights with relative ease, the current economic demand is for an extension of Heathrow's hub-and-spoke operation. The economic case for expansion at Heathrow is considered in Chapter 5.

50. In terms of supply, the problem is one of capacity. From the roads around the airport to the airspace above it, there is little room for expansion. New infrastructure can be built but, as we examine in the next chapter, airport expansion is fraught with competing priorities and limitations. Roger Sealey of Unite told the Committee that he thought he would "be well in my grave before a new airport [in the South East] would get planning permission."⁵⁴ Given that the prospect of a major new hub was rejected in the Government's *Future of Air Transport* White Paper, we agree with him.

51. In the past, a strong argument against breaking up BAA's ownership of the three London major London airports has been that since they did not operate in the same

53 Q 118, Ev 80

54 Q 131

markets—they did not sell the same product—there was nothing to compete over. To have the airports under separate ownership would not have increased competition because there would be nothing to compete over.

52. This point was confirmed in oral evidence from the airlines. Dr Ellis told us that “in terms of points to points services and the passengers using those, [...] there is very significant competition between Gatwick and Heathrow, and indeed Stansted comes into that equation as well.”⁵⁵ Brendan Gold of the Unite union told the committee that “the airports of the BAA have different markets to a greater extent, although the aviation industry is more blurred now between low fare and chartered players and the legacy carriers.”⁵⁶ Simon Evans of the Air Transport Users’ Council (AUC) noted that an individual may be a business passenger flying from Heathrow one week, and a no-frills leisure passenger flying from Stansted the next.⁵⁷

53. On an international basis, Heathrow competes with other major European hubs—e.g. Paris, Frankfurt and Schiphol—for stopover traffic. Dr Ellis described Heathrow as “the best we have got in terms of being a competitive hub [...] Heathrow is bad, but it is far and away the best opportunity we have got to be able to compete as a global hub”.⁵⁸ For American Airlines, Don Langford told us that:

With our customer flows to points beyond Europe, [...] Heathrow is becoming a less popular transit hub and we are finding that customers are making their transfers at other airports within Europe, and we believe this to be a trend which is continuing.⁵⁹

54. Heathrow is losing its popularity as a transit hub to other European airports. It is vital that Heathrow reverses this trend and retakes its place as the European hub of choice for international carriers. It is clear that a chronic shortage of capacity is hindering Heathrow’s ability to provide the sort of service to which it should aspire. We therefore support the Government’s proposal to add capacity at Heathrow. We consider capacity issues in more detail in Chapter 5 below.

Actual competition

55. Dr Bush explained the CAA’s view of the degree to which airports currently compete with each other:

We think there is interaction between those airports [Heathrow, Gatwick and Stansted] at the moment and interaction between the BAA airports and other airports in the system, so there are elements of competition there. We think that passengers do make choices between these airports. We do not believe that they are local monopolies in any sense; we think there is choice going on there. So there are the elements or the foundations for competition there, and around an airport like

55 Q 194

56 Q 117

57 Q 79

58 Q 193

59 Q 125

Stansted we think there is competitive pressure on Stansted from the airports around its boundary.⁶⁰

As regulator, the CAA has a birds-eye view of the sector and we accept its analysis.

56. Mr Banfield explained that the Competition Commission would consider “what competition there would be between separately owned airports within the London area”.⁶¹ He went on to explain that if Stansted or Gatwick were sold, the ability of an independent airport to increase competition would depend on:

the amount of capacity they may have, the extent to which they would compete in developing the facilities, the extent to which passengers or airlines would switch in response to lower prices and different investment programmes.⁶²

57. There is limited competition between UK airports. With the demarcation between different types of airports becoming ever less clear, the theoretical restrictions on competition decrease and the old argument against divestment—which denied the possibility of competition altogether—loses force. We feel that there is room for more competition (especially between BAA’s London airports) and that ending the current situation of common ownership would go a long way to realising this.

Operation

Spheres of responsibility

58. We have already described the connection between service quality and economic regulation. Although BAA is responsible for the operation of its airports, there are some things that it does not control. One very important area is security, where standards are set by the Transport Security and Contingencies section of the Department for Transport (Transec). BAA is responsible for meeting these standards. We received evidence that it had met difficulties on two fronts: contingency planning and recruiting enough security staff, particularly female search officers. Stephen Nelson of BAA admitted that before the security crisis which started on 10 August 2006, BAA “had insufficient staff for a steady state operation”.⁶³ He described the problems BAA experienced with recruiting security staff, which can take up to 20 weeks.⁶⁴ Following the security crisis, BAA took on 2,000 extra staff out of 35,000 applicants, which doubled the size of their force.⁶⁵

59. Mr Nelson explained that many other areas of service did not fall under BAA’s operational remit. The Home Office runs immigration, and the airlines employ the staff who operate baggage reclaim. Check-in desks are operated by the airlines and punctuality

60 Q 25

61 *ibid.*

62 Q 26

63 Q 209

64 Q 229

65 Q 233

of departure can be affected by many factors over which BAA has no control.⁶⁶ Simon Evans of the Air Transport Users' Council (AUC) explained that:

At Heathrow they [passengers] blame the airport because they have seen a lot of the press coverage and they know that Heathrow is a constrained airport. If they miss their flight or if it is the flight that is delayed rather than that they are having to queue a long time to get through check-in or security, they blame the airline, and that is the right thing to do because their contact is with the airline and it is the airline that has liability for any damage they have suffered as a result of their experience.⁶⁷

60. When things do go wrong for passengers, they are able to contact the AUC, which exists to “further the reasonable interests of users of air transport services”, a requirement placed upon the CAA by the Airports Act 1982.⁶⁸ In our report on Passengers' Experiences of Air Travel we commended the work of the AUC and recommended that “the CAA look at devising some kind of cross-subsidy for the Council from airport and airline fines for poor performance and that the Council does more to advertise itself”.⁶⁹ When we asked the AUC why it was not more proactive in its work, Simon Evans told us that this was not prioritised “because of the terms of reference and because of our budget”.⁷⁰

61. We have already called for the AUC's funding to be increased. It should become a proactive consumer body, going out and engaging with passengers. Its role to 'further the reasonable interests' of passengers should be interpreted as meaning more than just waiting for disgruntled passengers to make a complaint. However, if the AUC's terms of reference do need amending to allow it to become a genuinely proactive body, then the CAA and AUC should do so quickly.

62. BAA may feel as though it is taking a lot of the flak for things that are not part of its day to day responsibility, but this does not detract from the serious questions raised over mismanagement of resources and failure to plan adequately for contingencies which were far from unexpected, let alone inconceivable. With the ever-present possibility of extraordinary circumstances such as strikes or terrorist incidents, queues at airports are almost inevitable from time to time. Our criticism of BAA is that it should have predicted the predictable, and planned accordingly.

Capacity

Terminals

63. Many of the challenges relating to capacity at Heathrow have been attributed to lack of space in the terminals. With Terminal 5 due to open on 27 March 2008, the experience for many passengers will be much improved. Dr Harry Bush told us that:

66 Q 242

67 Q 97

68 Airports Act 1982, section 4(1)(b)

69 Transport Committee, *Passengers' Experiences of Air Travel*, para 147

70 Q 91

There has been, if you like, an excuse up to now which is that the airport has been very overcrowded [...] With the opening of T5 and the new investment that is being put in in this coming five years to improve the rest of the airport that excuse goes; that actually from now on there ought to be sufficient capacity to enable them to drive the sort of service quality that is needed.⁷¹

We asked the witnesses from BAA what difference they thought Terminal 5 would have upon operations at Heathrow. Stephen Nelson told us that:

Terminal 5 at a stroke will reduce the numbers of passengers going through Terminal 1 by about 50%, the numbers of passengers going through Terminal 4 by about 75%, and that will level out to 50, and the numbers of passengers going from Terminal 2 by about 15%. That will provide from April [2008] very considerable relief to passengers in physical terms.⁷²

64. The main benefits arising from T5 will be for passengers and British Airways. The increase in capacity that a fifth terminal provides has given BAA the opportunity to move airlines around and improve the condition of the other terminals. This will benefit all other airlines and their passengers. It is however regrettable that BAA ever allowed the position to get as bad as it did.

Runways

65. As many aircraft are taking off from UK airports as current capacity will allow. The Government's position on new runways was set out in the 2003 White Paper: that two more runways should be built in the south east, one at Stansted and the other at Heathrow. Further development at Gatwick was ruled out until at least 2019. 'Mixed mode' operations—where runways are used for both take-offs and landings—are a way of extending capacity, but can only be introduced after a public consultation. BAA's plans to introduce mixed mode at Heathrow are now being proposed as a 'stepping stone' between the current level of traffic and the level of traffic that a third runway would allow. It is to the plans for expansion at Heathrow that we now turn.

71 Q 19

72 Q 239

5 Expansion

Adding capacity at Heathrow airport

66. In 2003, our predecessor committee concluded that the future of airport development in the United Kingdom would be centred on targeted expansion of existing sites,⁷³ but that

a third runway at Heathrow would mean the destruction and relocation of a number of existing communities. Such a decision cannot be taken lightly.⁷⁴

67. The need for a third runway at Heathrow was identified in the Government's 2003 White Paper, *The Future of Air Transport*. Proposals for a second runway at Stansted were also backed by the White Paper. A second runway at Gatwick—while supported in principle—was ruled out before 2019, in accordance with the 1979 planning agreement between the then British Airports Authority and West Sussex County Council.

68. On 22 November 2007, the Department for Transport published *Adding capacity at Heathrow airport*, a consultation document on its proposals for a third runway and sixth terminal to the north of the present site.⁷⁵ *The Future of Air Transport* was a policy document, as although central government has no role in authorising development at airports, in practice development relating to large areas of national infrastructure does not take place without support from Government.

69. The current consultation document sets out three scenarios for development at Heathrow and invites members of the public to 'register their views', not on whether expansion should or should not go ahead, but rather on the three critical tests that expansion must pass:

- A noise limit – no increase in the size of the area significantly affected by aircraft noise (as measured by the 57dBA noise contour in 2002);
- Air quality limits – being confident of meeting European air quality limits around the airport, in particular for nitrogen dioxide (NO₂) which is the critical pollutant around Heathrow; and
- Improving public transport access to the airport.⁷⁶

70. We asked Mr Nelson why BAA had only recently advocated the development of a third runway. He told us that “up to [2003] there had been no government policy governing a runway expansion, no runway built in the last 50 years, and to that degree we have become

73 Transport Committee, *Aviation*, para 229

74 *ibid.*, para 222

75 Department for Transport, *Adding capacity at Heathrow airport*, 26 November 2007

76 *ibid.*, Ch.3

very firm supporters of the policy.”⁷⁷ BAA submitted a further memorandum, which gives a detailed history of their policy towards expansion.⁷⁸

71. We questioned the Minister on the Government’s consultation on expansion.⁷⁹ The Minister told us he was “very confident [...] that we can demonstrate to the satisfaction of the severest public scrutiny that those environmental standards can be demonstrated.”⁸⁰ When the Minister was asked what would happen if the conditions set out in the consultation document were not met, he told us that “We are satisfied now. We said that we would not go forward with support for the third runway unless we could satisfy ourselves that we could meet the criteria on noise and air quality.”⁸¹

Implications of the Planning Bill

72. The length of the planning process for T5 was formative in the Government’s decision to change planning law. The Planning White Paper mentioned the length of time it took to get planning permission for T5:

The process for dealing with major infrastructure projects, from submission of the proposal to decision in particular, is too slow and complicated. It took seven years to get to a decision on Heathrow Terminal 5.⁸²

73. The Secretary of State for Communities and Local Government (Hazel Blears) presented a Planning Bill to the House on 27 November 2007.⁸³ The Bill proposes “introducing a single consents regime for major infrastructure projects, establishing an Independent Infrastructure Planning Commission, and further measures to improve the Town and Country Planning System”.⁸⁴ The Bill removes the need for planning permission in the case of nationally significant infrastructure projects.⁸⁵ The definition of “nationally significant infrastructure projects” includes “the construction or extension of an airport”.⁸⁶ It is almost certain, therefore, that any new runway or terminal at Heathrow would be subject to the new planning regime envisaged by the Bill, rather than the current system.

Parliamentary scrutiny of National Policy Statements

74. In the debate on 10 December 2007, the Secretary of State for Communities and Local Government indicated that there would be Parliamentary scrutiny of National Policy Statements. The form that such scrutiny will take has yet to be decided but we anticipate that this Committee will have a role to play in it.⁸⁷

77 Q 263

78 Ev 81–84

79 Qq 318–338

80 Q 318

81 Q 319

82 Communities and Local Government, *Planning for a Sustainable Future*, Cm 7120, May 2007, para 1.20

83 Bill 11 (2007–08).

84 Planning Reform Bill: Key Benefits, <http://www.commonleader.gov.uk/output/page2166.asp>

85 Planning Bill, Section 29 (1)(a) [Bill 11 (2007–08)]

86 Planning Bill, Part 3, Clause 14, Subsection (1)(f) [Bill 11 (2007–08)]

87 HC Deb 10 December 2007, col 25

6 Options

Competition between terminals

Reorganisation and competition between terminals

75. One way of increasing competition would be to have more competition between terminals at Heathrow. This arose in oral evidence from easyJet. When questioned about alternatives to regulatory asset base regulation (where the value of an airport's assets form part of the basis of the charges it is allowed to make to airlines), Mr Toby Nicol said that:

There is no reason why, for example, a new terminal (which I am sure there will be in Stansted in due course) would have to be operated by BAA [...] You might begin to get a bit of competition between terminals within a particular airport, rather than simply giving more terminal capacity to BAA to spend.⁸⁸

76. In *Adding capacity at Heathrow airport*, the Department for Transport states that:

BAA is currently undertaking a programme of relocation of airlines at Heathrow to make best use of the airport and to co-locate airline alliance members in the same part of the airport. In 2008, British Airways will move the majority of its flights to Terminal 5. After this, BAA plan to group other airlines together by alliance to reduce transfer times for passengers. OneWorld will operate from Terminal 3, SkyTeam from Terminal 4 and Star Alliance from Terminal 1 and subsequently from the Heathrow East terminal.⁸⁹

77. Such reorganisation along alliance lines would seem to work in favour of competition between terminals. However, Mr Kyran Hanks, BAA's Economics and Regulation Director, told us that "there is not the space for that kind of competition at any of our London airports."⁹⁰ This view was echoed by Jonathan Moor, Director of Airports Strategy at the Department for Transport:

One thing I would say is that because they are looking specifically at development restrictions this is not as easy as it is maybe in some places like America. If you look at JFK Airport, they have nine different terminals there. We already know how difficult it was to get a fifth terminal at Heathrow Airport, so one of the key problems for us in the South East is that the development restrictions and the capacity restrictions will make it very difficult to have inter-terminal competition within an airport.⁹¹

78. Competition between terminals at Heathrow could have been a radical solution to the problem of competition at Heathrow. If neither the Government nor BAA believe

88 Q 173

89 *Adding capacity at Heathrow airport*, para 3.16

90 Q 272

91 Q 339

that inter-terminal competition is an option at Heathrow, then it makes the prospect of divestment even more likely.

Divestment

79. In the course of previous inquiries into the aviation sector, we have recommended that the BAA group be broken up.⁹² BAA stated:

We consider the case for break-up to be weak, in that it does not appear to have considered the fundamental questions surrounding the delivery of new capacity. Genuine competition would only be possible with that new capacity. T5 is the future. BAA has ambitious plans for all its airports and a stable ownership structure is a key aspect of transforming airports.⁹³

In its written evidence, BAA poses several questions to us:

- How can there be competition between airports without spare capacity?
- How can price-controlled airports compete on price?
- How would separate owners deliver capacity any faster than BAA?
- How would the inevitable delays in delivering service improvements and new capacity, caused by break-up, be addressed?
- Would separate owners have the necessary skills and experience?
- Would separate owners have the financial strength of BAA?⁹⁴

80. This gives us the opportunity to set out a few key points in response. Any airport that were sold off would not be price-controlled, as it would be in a position of market power, and thus would be free to compete on price. Two of the things BAA does not have a monopoly on are skills and experience, and we are not persuaded that it would necessarily deliver new capacity faster than any other potential owner. We are confident that any new owner would have (at the very least) the financial strength of BAA, and might well be stronger.

81. There are more limitations on supply than there are on demand in the aviation sector, and there are no signs that this will change. To assume that spare capacity is necessary for competition is to deny the possibility of competition altogether. We have heard evidence from the CAA that there is indeed competition, particularly in the

92 *Passengers' Experiences of Air Travel*, para 64. See also *The Work of the Civil Aviation Authority*, para 142.

93 Ev 76

94 Ev 80

point-to-point and low-cost sectors. If competition is taking place without spare capacity—as the CAA say that it is—then it must be possible.

82. EasyJet’s Communications Director, Toby Nicol, argued that “what would be worse than a single monopoly controlling Heathrow, Gatwick and Stansted would be three individual monopolies.”⁹⁵ He explained that “they all have a monopoly of their local markets. Stansted, Gatwick and Heathrow do, and in effect what you would do is simply create mini-monopolies rather than a big monopoly.”⁹⁶ However, in a supplementary written submission, Mr Nicol clarified easyJet’s position: “easyJet supports the break-up of BAA, but [...] this should not be at the expense of effective regulation of BAA’s three London airports.”⁹⁷

83. We agree that breaking up BAA’s monopoly would not remove the need for effective regulation. What it would remove though—through the removal of substantial market power—would be the need for the kind of economic regulation in the form of price controls. Further, and in all likelihood deliberate, ‘blurring’ of the passenger markets as described by Unite would result in increased potential competition between airports and, because there would be separate economic interests, increased actual competition for passengers.

Which airport?

84. There has been speculation in the media to the effect that BAA and Ferrovial have plans to sell off either Gatwick or Stansted.⁹⁸ As the airport in the South East least likely to see development and extra capacity in the next fifteen years, Gatwick is possibly more expendable than Stansted. In August 2007, *The Business* reported that there would be a ‘feeding frenzy’ if BAA were forced to sell Gatwick.⁹⁹ It will be for the Competition Commission to consider all the options facing BAA, and we await its findings and recommendations.

85. BAA’s monopoly position in the UK airports sector is unnecessary. Indeed, it is bad for passengers and bad for the aviation industry. We do not agree that the status quo is a necessary condition of sustained investment and development. We are firmly of the view that increased competition is possible and could have huge benefits for both airlines and passengers. We look forward to the Competition Commission’s analysis of all the issues, and hope that it undertakes detailed cost-benefit analyses of all the possible outcomes.

95 Q 183

96 Q 184

97 Ev 124

98 e.g. ‘Something in the City: Airport for sale?’, *The Evening Standard*, 4 October 2007, p 37

99 ‘London City airport eyes Gatwick as BAA empire faces break-up’, *The Business*, 18 August 2007

7 Conclusion

86. The continuing demand for capacity at our airports raises important questions about the nature and extent of expansion. BAA's position in the market means that what is good for aviation is usually good for BAA. Where our views diverge is that we do not think that what is good for BAA is necessarily good for aviation. BAA claim to be best placed to deliver new capacity. It would be a strange company indeed that did not make such a claim. To date, this has been their key argument in favour of retaining common ownership of—in particular—Heathrow, Gatwick and Stansted.

87. However, the evidence we have received over the course of this inquiry and our previous inquiries into aviation leads us to a different conclusion. It is our view that the drawbacks of common ownership outweigh the advantages, and that there is much to be gained from a state of affairs where BAA did not enjoy such substantial market power. The extent to which BAA needs chivvy along by the regulator reflects poorly on their avowed commitment to service quality. We are sceptical of arguments which deny the possibility of increased competition: our evidence from the CAA indicates that this simply is not the case. We hope that the Competition Commission will take the steps necessary to ensure a healthy, competitive airports sector for the years to come.

List of recommendations

Regulation

1. The Competition Commission should not automatically be involved in the review of airport charges. Instead, it should be a body to which the airport operators may go if they wish to appeal. We welcome the Government's announcement of the strategic review of the CAA, and hope that Sir Joseph Pilling will take note of the consensus that has emerged around the question of the nature of the future relationship between the CAA and the Competition Commission. (Paragraph 25)
2. We agree with the CAA that economic regulation should only apply where there is a need for it, and therefore welcome the Department's decision to de-designate Manchester airport. Although Stansted will remain a designated airport for the immediate future, we are confident that the circumstances of BAA's common ownership will change in the foreseeable future, either through the actions of the Competition Commission or BAA. (Paragraph 29)
3. The real problem in the airports sector is that there is a need for economic regulation at all. The fact that regulatory asset base regulation brings problems of its own is another issue entirely. Piecemeal ownership of terminals by companies other than BAA is not radical enough a solution to the problem of BAA's monopoly. (Paragraph 35)
4. It was, and remains, our view that BAA should be doing a lot of things covered by the incentives anyway. We have no issue with the principle of performance-related pay as applied through service quality rebates. We do, however, regret the apparent need for such targets. If there were no position of market power in the UK airports sector—if there was real competition for traffic—airport owners would not need incentives from an external regulator. (Paragraph 45)
5. We believe that the percentage of revenue subject to rebates should be higher, as suggested by the Competition Commission. The comparison of the regulation of BAA to an anti-trust regime lends further weight to our view that BAA's market position is fundamentally anti-competitive. (Paragraph 47)

Challenges

6. We believe a competitive airports sector would be better than the current state of affairs, where in our opinion competition is stifled by common ownership of several major airports. Airports under separate ownership would have to compete for traffic. This would also have positive consequences for passengers. BAA's common ownership is holding back the natural development of the market, where discrete passenger markets are less well-defined. (Paragraph 48)
7. Heathrow is losing its popularity as a transit hub to other European airports. It is vital that Heathrow reverses this trend and retakes its place as the European hub of choice for international carriers. It is clear that a chronic shortage of capacity is

hindering Heathrow's ability to provide the sort of service to which it should aspire. We therefore support the Government's proposal to add capacity at Heathrow. (Paragraph 54)

8. There is limited competition between UK airports. With the demarcation between different types of airports becoming ever less clear, the theoretical restrictions on competition decrease and the old argument against divestment—which denied the possibility of competition altogether—loses force. We feel that there is room for more competition (especially between BAA's London airports) and that ending the current situation of common ownership would go a long way to realising this. (Paragraph 57)
9. We have already called for the AUC's funding to be increased. It should become a proactive consumer body, going out and engaging with passengers. Its role to 'further the reasonable interests' of passengers should be interpreted as meaning more than just waiting for disgruntled passengers to make a complaint. However, if the AUC's terms of reference do need amending to allow it to become a genuinely proactive body, then the CAA and AUC should do so quickly. (Paragraph 61)
10. BAA may feel as though it is taking a lot of the flak for things that are not part of its day to day responsibility, but this does not detract from the serious questions raised over mismanagement of resources and failure to plan adequately for contingencies which were far from unexpected, let alone inconceivable. With the ever-present possibility of extraordinary circumstances such as strikes or terrorist incidents, queues at airports are almost inevitable from time to time. Our criticism of BAA is that it should have predicted the predictable, and planned accordingly. (Paragraph 62)
11. The main benefits arising from T5 will be for passengers and British Airways. The increase in capacity that a fifth terminal provides has given BAA the opportunity to move airlines around and improve the condition of the other terminals. This will benefit all other airlines and their passengers. It is however regrettable that BAA ever allowed the position to get as bad as it did. (Paragraph 64)

Options

12. Competition between terminals at Heathrow could have been a radical solution to the problem of competition at Heathrow. If neither the Government nor BAA believe that inter-terminal competition is an option at Heathrow, then it makes the prospect of divestment even more likely. (Paragraph 78)
13. There are more limitations on supply than there are on demand in the aviation sector, and there are no signs that this will change. To assume that spare capacity is necessary for competition is to deny the possibility of competition altogether. We have heard evidence from the CAA that there is indeed competition, particularly in the point-to-point and low-cost sectors. If competition is taking place without spare capacity—as the CAA say that it is—then it must be possible. (Paragraph 81)
14. BAA's monopoly position in the UK airports sector is unnecessary. Indeed, it is bad for passengers and bad for the aviation industry. We do not agree that the status quo

is a necessary condition of sustained investment and development. We are firmly of the view that increased competition is possible and could have huge benefits for both airlines and passengers. We look forward to the Competition Commission's analysis of all the issues, and hope that it undertakes detailed cost-benefit analyses of all the possible outcomes. (Paragraph 85)

Formal Minutes

Wednesday 27 February 2008

Members present:

Clive Efford	Mr Eric Martlew
Mrs Louise Ellman	Mr Lee Scott
Mr Philip Hollobone	Mr Graham Stringer
Mr John Leech	Mr David Wilshire

Draft Report (*The future of BAA*), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 4 read and agreed to.

Paragraph 5 read, amended and agreed to.

Paragraph 6 read and agreed to.

Paragraph 7 read, amended and agreed to.

Paragraphs 8 to 15 read and agreed to.

Paragraph 16 read, amended and agreed to.

Paragraph 17 read and agreed to.

Paragraph 18 read, as follows:

"The main issues identified by the Competition Commission as relevant to their investigation are the regulatory framework, the common ownership of airports by BAA and the restrictions on development and capacity. These issues are central to our own inquiry, and while we hope that the Commission will take our conclusions and recommendations into account, we do not believe our report will prejudice whatever conclusions it may come to. As at February 2008, the Commission hoped to publish its emerging thinking in around April 2008, with provisional findings and remedies following in August 2008 and a final report to be made in December 2008."

Amendment proposed, in line 4, to leave out from "inquiry," to the "As" in line 6.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 3
Mr Philip Hollobone	Mrs Louise Ellman
Mr Lee Scott	Mr John Leech
Mr David Wilshire	Mr Graham Stringer

Whereupon the Chairman declared herself with the Noes.

Paragraph agreed to.

Paragraphs 19 to 28 read and agreed to.

Paragraph 29 read, as follows:

“We agree with the CAA that economic regulation should only apply where there is a need for it, and therefore welcome the Department’s decision to de-designate Manchester airport. Although Stansted will remain a designated airport for the immediate future, we are confident that the circumstances of BAA’s common ownership will change in the foreseeable future, either through the actions of the Competition Commission or BAA.”

Amendment proposed, in line 3, to leave out from first “airport” to the end of the paragraph and add “We also agree that it makes sense for Stansted to remain a designated airport at least until the Competition Commission has completed its review”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 4
Mr Philip Hollobone	Clive Efford
Mr Lee Scott	Mrs Louise Ellman
Mr David Wilshire	Mr John Leech
	Mr Graham Stringer

Paragraph agreed to.

Paragraphs 30 to 34 read and agreed to.

Paragraph 35 read, amended and agreed to.

Paragraph 36 to 46 read and agreed to.

Paragraph 47 read, as follows:

“We believe that the percentage of revenue subject to rebates should be higher, as suggested by the Competition Commission. The comparison of the regulation of BAA to an anti-trust regime lends further weight to our view that BAA’s market position is fundamentally anti-competitive.”

Amendment proposed, in line 2, to leave out from “Commission” to the end of the paragraph.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 4
Mr Philip Hollobone	Clive Efford

Mr Lee Scott
Mr David Wilshire

Mrs Louise Ellman
Mr John Leech
Mr Graham Stringer

Paragraph agreed to.

Paragraph 48 read, as follows:

“Both BAA and the trade unions asserted that common ownership of the London airports is a necessary condition of effective investment. We disagree, and set out our reasons for doing so below. We believe a competitive airports sector would be better than the current state of affairs, where in our opinion competition is stifled by common ownership of several major airports. Airports under separate ownership would have to compete for traffic. This would also have positive consequences for passengers. BAA’s common ownership is holding back the natural development of the market, where discrete passenger markets are less well-defined.”

Amendment proposed, in line 3, to leave out from “below” to the end of the paragraph.—
(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2
Mr Philip Hollobone
Mr David Wilshire

Noes, 4
Clive Efford
Mrs Louise Ellman
Mr John Leech
Mr Graham Stringer

Paragraph agreed to.

Paragraph 49 read, as follows:

“It is important to stress that competition in the airports sector is subject to several major limiting factors. When a competitive airports sector is referred to, it should be qualified by an awareness of these limitations. The problem is one of supply and demand. The demand for air transport is not evenly spread, or even all of the same type. There is more demand for capacity in the South East of England, and that demand can be split in several ways, short vs. long haul and business vs. leisure being the two most obvious. The problem with supply is also complicated in that different airports can also be categorised as (predominantly) serving different modes of transport. ‘Hub-and-spoke’ model works with large airports through which flights are directed, even if that airport is not the final destination. A lot of Heathrow’s traffic is ‘hub-and-spoke’, and it is thus referred to as a hub airport. In ‘point-to-point’ flying, the passenger boards a plane and flies directly to his final destination, which might be a large hub airport or a smaller regional airport. While it is possible to build a small airport capable of flying a modest number of point-to-point flights with relative ease, the current economic demand is for an extension of Heathrow’s hub-and-spoke operation. The economic case for expansion at Heathrow is considered in Chapter 5.”

Amendment proposed, in line 3, after first “demand.” to insert “It is also important to understand that effective competition will take place between similar types of service (e.g. point-to-point services) rather than between airports offering different services.”—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 4
Mr Philip Hollobone	Clive Efford
Mr Lee Scott	Mrs Louise Ellman
Mr David Wilshire	Mr John Leech
	Mr Graham Stringer

An Amendment made.

Paragraph, as amended, agreed to.

Paragraphs 50 to 54 read and agreed to.

Paragraph 55 read, amended and agreed to.

Paragraph 56 read and agreed to.

Paragraph 57 read, as follows:

“There is limited competition between UK airports. With the demarcation between different types of airports becoming ever less clear, the theoretical restrictions on competition decrease and the old argument against divestment—which denied the possibility of competition altogether—loses force. We feel that there is room for more competition (especially between BAA’s London airports) and that ending the current situation of common ownership would go a long way to realising this.”

Amendment proposed, in line 1, to leave out from “airports” to the end of the paragraph and add “and significant and increasing competition from foreign airports. The decreasing demarcation between different types of airport will lead to airlines offering more competing services and routes from different airports. We hope this trend will gather pace.”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 4
Mr Philip Hollobone	Clive Efford
Mr Lee Scott	Mrs Louise Ellman
Mr David Wilshire	Mr John Leech
	Mr Graham Stringer

Paragraph agreed to.

Paragraph 58 read, as follows:

“We have already described the connection between service quality and economic regulation. Although BAA is responsible for the operation of its airports, there are some things that it does not control. One very important area is security, where standards are set by the Transport Security and Contingencies section of the Department for Transport (Transec). BAA is responsible for meeting these standards. We received evidence that it had met difficulties on two fronts: contingency planning and recruiting enough security staff, particularly female search officers. Stephen Nelson of BAA admitted that before the security crisis which started on 10 August 2006, BAA “had insufficient staff for a steady state operation”. He described the problems BAA experienced with recruiting security staff, which can take up to 20 weeks. Following the security crisis, BAA took on 2,000 extra staff out of 35,000 applicants, which doubled the size of their force.”

Amendment proposed, in line 2, to leave out “some” and insert “many”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 3
Mr Philip Hollobone	Clive Efford
Mr Lee Scott	Mrs Louise Ellman
Mr David Wilshire	Mr John Leech

Whereupon the Chairman declared herself with the Noes.

Paragraph agreed to.

Paragraphs 59 to 61 read and agreed to.

Paragraph 62 read, as follows:

“BAA may feel as though it is taking a lot of the flak for things that are not part of its day to day responsibility, but this does not detract from the serious questions raised over mismanagement of resources and failure to plan adequately for contingencies which were far from unexpected, let alone inconceivable. With the ever-present possibility of extraordinary circumstances such as strikes or terrorist incidents, queues at airports are almost inevitable from time to time. Our criticism of BAA is that it should have predicted the predictable, and planned accordingly.”

Amendment proposed, in line 6, to leave out from “time to time” to the end of the paragraph and add “especially when fundamental changes to a security regime are made with nil notice.”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2	Noes, 5
Mr Philip Hollobone	Clive Efford

Mr David Wilshire

Mrs Louise Ellman
Mr John Leech
Mr Lee Scott
Mr Graham Stringer

Paragraph agreed to.

Paragraph 63 read, amended and agreed to.

Paragraph 64 read, as follows:

“The main benefits arising from T5 will be for passengers, not airlines. The increase in capacity that a fifth terminal provides has given BAA the opportunity to move airlines around and improve the condition of the other terminals, but it is regrettable that BAA ever allowed the position to get as bad as it did.”

Amendments made.

Another Amendment proposed, in line 3, to leave out “, but it is regrettable that BAA ever allowed the position to get as bad as it did”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2
Mr Philip Hollobone
Mr David Wilshire

Noes, 4
Clive Efford
Mrs Louise Ellman
Mr John Leech
Mr Graham Stringer

Paragraph, as amended, agreed to.

Paragraph 65 read, as follows:

“As many aircraft are taking off from UK airports as current capacity will allow. The Government’s position on new runways was set out in the 2003 White Paper: that two more runways should be built in the south east, one at Stansted and the other at Heathrow. Further development at Gatwick was ruled out until at least 2019. ‘Mixed mode’ operations—where runways are used for both take-offs and landings—are a way of extending capacity, but can only be introduced after a public consultation. BAA’s plans to introduce mixed mode at Heathrow are now being proposed as a ‘stepping stone’ between the current level of traffic and the level of traffic that a third runway would allow. It is to the plans for expansion at Heathrow that we now turn.”

Amendment proposed, in line 8, after “allow.” insert “We hope that runway alternation will be reintroduced when the new runway is opened.”—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2
Mr Philip Hollobone
Mr David Wilshire

Noes, 4
Clive Efford
Mrs Louise Ellman
Mr John Leech
Mr Graham Stringer

Paragraph agreed to.

Paragraphs 66 to 74 read and postponed.

Paragraphs 75 to 77 read and agreed to.

Paragraph 78 read, as follows:

“Competition between terminals at Heathrow could have been a radical solution to the problem of competition at Heathrow. If neither the Government nor BAA believe that inter-terminal competition is an option at Heathrow, then it makes the prospect of divestment even more likely.”

Amendment proposed, in line 1, to leave out “have been” and insert “be”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3
Mr Philip Hollobone
Mr Lee Scott
Mr David Wilshire

Noes, 5
Clive Efford
Mrs Louise Ellman
Mr John Leech
Mr Eric Martlew
Mr Graham Stringer

Another Amendment proposed, in line 2, to leave out from “Heathrow.” to the end of the paragraph.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2
Mr Philip Hollobone
Mr David Wilshire

Noes, 5
Clive Efford
Mrs Louise Ellman
Mr John Leech
Mr Eric Martlew
Mr Graham Stringer

Paragraph agreed to.

Paragraph 79 read and agreed to.

Paragraph 80 read, as follows:

“This gives us the opportunity to set out a few key points in response. Any airport that were sold off would not be price-controlled, as it would be in a position of market power, and thus would be free to compete on price. Two of the things BAA does not have a monopoly on are skills and experience, and we are not persuaded that it would necessarily deliver new capacity faster than any other potential owner. We are confident that any new owner would have (at the very least) the financial strength of BAA, and might well be stronger.”

Amendment proposed, in line 5, to leave out “We are confident that”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2	Noes, 4
Mr Philip Hollobone	Clive Efford
Mr David Wilshire	Mrs Louise Ellman
	Mr John Leech
	Mr Eric Martlew

Another Amendment proposed, in line 6, to leave out “, and might well be stronger”.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 4
Mr Philip Hollobone	Clive Efford
Mr Lee Scott	Mrs Louise Ellman
Mr David Wilshire	Mr Eric Martlew
	Mr Graham Stringer

Paragraph agreed to.

Paragraphs 81 to 84 read and agreed to.

Paragraph 85 read, as follows:

“BAA’s monopoly position in the UK airports sector is unnecessary. Indeed, it is bad for passengers and bad for the aviation industry. We do not agree that the status quo is a necessary condition of sustained investment and development. We are firmly of the view that increased competition is possible and could have huge benefits for both airlines and passengers. We look forward to the Competition Commission’s analysis of all the issues, and hope that it undertakes detailed cost-benefit analyses of all the possible outcomes.”

Question put, That the paragraph stand part of the Report.

The Committee divided.

Ayes, 6
 Clive Efford
 Mrs Louise Ellman
 Mr John Leech
 Mr Eric Martlew
 Mr Lee Scott
 Mr Graham Stringer

Noes, 2
 Mr Philip Hollobone
 Mr David Wilshire

Paragraph 86 read and agreed to.

Paragraph 87 read, as follows:

“However, the evidence we have received over the course of this inquiry and our previous inquiries into aviation leads us to a different conclusion. It is our view that the drawbacks of common ownership outweigh the advantages, and that there is much to be gained from a state of affairs where BAA did not enjoy such substantial market power. The extent to which BAA needs chivvying along by the regulator reflects poorly on their avowed commitment to service quality. We are sceptical of arguments which deny the possibility of increased competition: our evidence from the CAA indicates that this simply is not the case. We hope that the Competition Commission will take the steps necessary to ensure a healthy, competitive airports sector for the years to come.”

Question put, That the paragraph stand part of the Report.

The Committee divided.

Ayes, 5
 Clive Efford
 Mrs Louise Ellman
 Mr John Leech
 Mr Eric Martlew
 Mr Graham Stringer

Noes, 3
 Mr Philip Hollobone
 Mr Lee Scott
 Mr David Wilshire

A paragraph—(*Mr David Wilshire*)—brought up and read, as follows:

“The evidence we have received over the course of this inquiry seeks to make the case for and against maintaining the status quo. We hope the Competition Commission will consider our evidence alongside all the other evidence it obtains and then comes forward with proposals that will maintain a prosperous British airports sector which is robust enough to maintain its leading role in Europe.”—(*Mr David Wilshire*.)

Question put, That the paragraph be read a second time.

The Committee divided.

Ayes, 3
 Mr Philip Hollobone
 Mr Lee Scott
 Mr David Wilshire

Noes, 5
 Clive Efford
 Mrs Louise Ellman
 Mr John Leech
 Mr Eric Martlew

Mr Graham Stringer

Ordered, That consideration of the Chairman's draft Report be now adjourned.— (*The Chairman.*)

Report to be further considered on Wednesday 5 March.

WEDNESDAY 5 MARCH 2008

Members present:

Mr David Clelland	Mr John Leech
Mrs Gwyneth Dunwoody	Mr Eric Martlew
Clive Efford	David Simpson
Mrs Louise Ellman	Mr Graham Stringer
Mr Philip Hollobone	Mr David Wilshire

In the temporary absence of the Chairman, Mr Graham Stringer was called to the Chair for part of the meeting.

Consideration of the Chairman's draft Report resumed.

Postponed paragraph 66 again read as follows:

“In 2003, our predecessor committee concluded that the future of airport development in the United Kingdom would be centred on targeted expansion of existing sites, but that

‘a third runway at Heathrow would mean the destruction and relocation of a number of existing communities. Such a decision cannot be taken lightly.’”

Amendment proposed, in line 2, to leave out from “sites” to the end of the paragraph.— (*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3	Noes, 3
Mr Philip Hollobone	Clive Efford
David Simpson	Mrs Louise Ellman
Mr David Wilshire	Mr John Leech

Whereupon the Chairman declared himself with the Noes.

Question put, That the paragraph stand part of the Report.

The Committee divided.

Ayes, 4	Noes, 2
Mr David Clelland	Mr Philip Hollobone
Clive Efford	Mr David Wilshire
Mrs Louise Ellman	

Mr John Leech

Postponed paragraphs 67 and 68 again read.

Question put, That the paragraphs stand part of the Report.

The Committee divided.

Ayes, 4

Mr David Clelland

Clive Efford

Mrs Louise Ellman

Mr John Leech

Noes, 2

Mr Philip Hollobone

Mr David Wilshire

Postponed paragraph 69 again read as follows:

“The current consultation document sets out three scenarios for development at Heathrow and invites members of the public to ‘register their views’, not on whether expansion should or should not go ahead, but rather on the three critical tests that expansion must pass:

- “A noise limit – no increase in the size of the area significantly affected by aircraft noise (as measured by the 57dBA noise contour in 2002);
- “Air quality limits – being confident of meeting European air quality limits around the airport, in particular for nitrogen dioxide (NO₂) which is the critical pollutant around Heathrow; and
- “Improving public transport access to the airport.”

Amendment proposed, in line 2, to leave out from “views” to “on” in line 3.—(*Mr David Wilshire.*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 2

Mr Philip Hollobone

Mr David Wilshire

Noes, 4

Clive Efford

Mrs Louise Ellman

Mr John Leech

David Simpson

Question put, That the paragraph stand part of the Report.

The Committee divided.

Ayes, 4

Mr David Clelland

Noes, 2

Mr Philip Hollobone

Clive Efford
Mrs Louise Ellman
Mr John Leech

Mr David Wilshire

Postponed paragraphs 70 to 74 again read.

Question put, That the paragraphs stand part of the Report.

The Committee divided.

Ayes, 5
Mr David Clelland
Mrs Gwyneth Dunwoody
Clive Efford
Mrs Louise Ellman
Mr John Leech

Noes, 2
Mr Philip Hollobone
Mr David Wilshire

Motion made, and Question put, That the Report, as amended, be the Fourth Report of the Committee to the House.

The Committee divided.

Ayes, 6
Mr David Clelland
Mrs Gwyneth Dunwoody
Clive Efford
Mrs Louise Ellman
Mr Eric Martlew
David Simpson

Noes, 3
Mr John Leech
Mr Philip Hollobone
Mr David Wilshire

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Wednesday 19 March at 2.30 pm.]

Witnesses

Wednesday 21 November 2007

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Martin Stanley, Chief Executive, **John Banfield**, Inquiry Director, Competition Commission, **Harry Bush**, Group Director Economic Regulation, **Daniel Storey**, Head, Airport Price Controls, Civil Aviation Authority Ev 1

Simon Evans, Chief Executive, Air Transport Users' Council Ev 9

Roger Sealey, Transport Researcher, **Brendan Gold**, National Officer, Unite the Union, **Paul Smith**, Aviation Group secretary, **Dennis Burke**, President, BAA section of the Aviation Group, Public and Commercial Services Union Ev 14

Wednesday 28 November 2007

Dr Paul Ellis, General Manager, Infrastructure Policy and Economic Regulation, British Airways plc, **Toby Nicol**, Communications Director, easyJet, **Don Langford**, Managing Director, Services – Europe & India, American Airlines Ev 21

Stephen Nelson, Chief Executive, **Sir Nigel Rudd**, Non-Executive Chairman, **Kyran Hanks**, Director of Regulation, BAA Ltd Ev 28

Jim Fitzpatrick MP, Parliamentary Under Secretary of State, **Jonathan Moor**, Director of Airport Strategy, Department for Transport Ev 37

List of written evidence

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2	Alan Godsal	Ev 46
3	Gatwick Area Conservation Campaign	Ev 46
4	T Martin Blaiklock	Ev 48
5	Heathrow Association for the Control of Aircraft Noise (HACAN)	Ev 49
6	Royal Aeronautical Society	Ev 53
7	Greenpeace UK	Ev 55
8	Association of British Insurers	Ev 56
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10	Department for Transport	Ev 59, Ev 125
11	London Borough of Hounslow	Ev 63
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13	Stop Stansted Expansion	Ev 68, 72
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16	British Airways	Ev 84
17	Federation of Tour Operators.	Ev 88
18	Heathrow AOC	Ev 90
19	Unite the Union	Ev 93
20	Board of Airline Representatives in the UK (BAR UK) and the International Air Transport Association (IATA)	Ev 97
21	City of Edinburgh Council and Edinburgh Chamber of Commerce	Ev 101
22	American Airlines Inc	Ev 104
23	Glasgow Prestwick Airport Consultative Committee (GPACC)	Ev 107
24	Plymouth City Council	Ev 107
25	National Air Traffic Service (NATS)	Ev 110
26	Civil Aviation Authority	Ev 112
27	Independent Airport Park and Ride Association (IAPRA)	Ev 115
28	Virgin Atlantic Airways	Ev 119
29	Office of the City Remembrancer	Ev 122
30	easyJet	Ev 123, 124

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First Report	Galileo: Recent Developments	HC 53
Second Report	The London Underground and the Public-Private Partnership Agreements	HC 45
Third Report	Work of the Committee in 2007	HC 248
Fourth Report	The future of BAA	HC 119
First Special Report	Galileo: Recent Developments: Government Response to the Committee's First Report of Session 2007–08	HC 283

Session 2006–07

First Report	Work of the Committee in 2005–06	HC 226
Second Report	The Ports Industry in England and Wales	HC 61-I & 61-II
Third Report	Transport for the London 2012 Olympic and Paralympic Games: The Draft Transport Plan	HC 199
Fourth Report	Department for Transport Annual Report 2006	HC 95
Fifth Report	The Government's Motorcycling Strategy	HC 264
Sixth Report	The new National Boatmasters' Licence	HC 320-I & 320-II
Seventh Report	Novice Drivers	HC 355-I & 355-II
Eighth Report	Passengers' Experiences of Air Travel	HC 435-I & 435-II
Ninth Report	The draft Local Transport Bill and the Transport Innovation Fund	HC 692-I & 692-II
First Special Report	Passenger Rail Franchising: Government Response to the Committee's Fourteenth Report of Session 2005–06	HC 265
Second Special Report	Roads Policing and Technology: Getting the right balance: Government Response to the Committee's Tenth Report of Session 2005–06	HC 290
Third Special Report	Bus services across the UK: Government Response to the Committee's Eleventh Report of Session 2005–06	HC 298
Fourth Special Report	Local Transport Planning and Funding: Government Response to the Committee's Twelfth Report of Session 2005–06	HC 334
Fifth Special Report	The work of the Civil Aviation Authority: Government Response to the Committee's Thirteenth Report of Session 2005–06	HC 371
Sixth Special Report	Transport for the London 2012 Olympic and Paralympic Games: The Draft Transport Plan:	HC 484

	Olympic Delivery Authority Response to the Committee's Third Report of Session 2006–07	
Seventh Special Report	Department for Transport Annual Report 2006: Government Response to the Committee's Fourth Report of Session 2006–07	HC 485
Eighth Special Report	The Government's Motorcycling Strategy: Government Response to the Committee's Fifth Report of Session 2006–07	HC 698
Ninth Special Report	The Ports Industry in England and Wales: Government Response to the Committee's Second Report of Session 2006–07	HC 954

Oral evidence

Taken before the Transport Committee

on Wednesday 21 November 2007

Members present

Mrs Gwyneth Dunwoody, in the Chair

Mr David Clelland
Clive Efford
Mr Philip Hollobone

David Simpson
Mr David Wilshire

Witnesses: **Mr Martin Stanley**, Chief Executive, **Mr John Banfield**, Inquiry Director, Competition Commission, **Mr Harry Bush**, Group Director Economic Regulation and **Mr Daniel Storey**, Head, Airport Price Controls, Civil Aviation Authority gave evidence.

Chairman: Before we begin, gentlemen, we do have one bit of housekeeping to perform, if you will indulge us for the moment. Members having an interest to declare. Mr Clelland.

Mr Clelland: Member of the trade union Unite.

Chairman: Mr Efford.

Clive Efford: Member of Unite.

Chairman: Gwyneth Dunwoody, ASLEF. Anyone having an interest to declare?

Mr Wilshire: Chairman, I have never yet established whether or not I do so I always declare it on these occasions. I represent a significant number of employees on BAA; I represent parts of Heathrow Airport. It gives me the chance to say that I do not have any financial interest in the company.

Chairman: That is probably one of your other mistakes, but thank you for telling us!

Mr Wilshire: It is the price one pays, Chairman.

Q1 Chairman: Gentlemen, good afternoon. Thank you very much for coming. Those of you who have been here before know the house rules; the microphones in front of you record but do not project. This is a room that absorbs sound, so if you would be kind enough to speak up. I am going to ask you firstly, for the record, to identify yourselves starting on my left.

Mr Banfield: John Banfield, Inquiry Director at the Competition Commission.

Mr Stanley: Martin Stanley, Chief Executive of the Competition Commission.

Dr Bush: Harry Bush, Group Director Economic Regulation, CAA.

Mr Storey: Daniel Storey, Head of Airport Price Control at the CAA.

Q2 Chairman: Thank you very much. Gentlemen, did any or all of you have something that you wanted to say before we begin? Mr Stanley, you are drawing breath there?

Mr Stanley: Chairman, if I briefly explain that we have a group of six of our members chaired by Christopher Clarke currently carrying out an inquiry into BAA. They will obviously take careful note of what is said this afternoon and of any report

that is produced. In the meantime John and I will do our best to answer the Committee's questions but will clearly have to be a little careful not to go too far.

Q3 Chairman: That is very kind of you, Mr Stanley. This Committee welcomes the opportunity to talk to suitably informed witnesses. We are delighted to hear that anybody takes notice of what we say! You will understand that there are no indiscreet questions, there are only indiscreet answers, so we will try not to trespass but the Committee is of course unfortunately committed to getting information, which is boring but there you go!

Dr Bush: From the CAA's point of view we have put in our evidence and we also published yesterday, of course, our price control proposals for Heathrow and Gatwick, of which we have sent the Committee copies.

Q4 Chairman: To be fair, Dr Bush, I do think you might get the odd question about what you said yesterday.

Dr Bush: We are very happy to take that; we thought we might.

Q5 Chairman: I thought it would probably have crossed your mind. I do not quite know how you want to organise this but could you describe your respective roles in the regulation of the UK aviation sector? Who is going to start? Mr Stanley.

Mr Stanley: We currently have two roles. First of all, once every five years we give advice to the CAA on the price controls that might apply for the forthcoming five years at Heathrow, Gatwick and, if appropriate, at other airports. We delivered our advice to the CAA a few weeks ago; they have taken account of it and yesterday I think published their final proposals for the price controls. So we have an essentially automatic advisory role every five years for price controls. Quite separately and rather unusually we were asked, again about six months ago, by the Office of Fair Trading to investigate BAA in the round and to consider any competition matters that might occur to us and we are getting up to steam on that inquiry, having spent the first six months inevitably focusing more on price controls.

21 November 2007 Mr Martin Stanley, Mr John Banfield, Mr Harry Bush and Mr Daniel Storey

Q6 Chairman: That is helpful, Mr Stanley. Dr Bush.

Dr Bush: Our role centres on I think three elements: first of all, the price control of the designated airports. The three BA airports in London and Manchester, two of those are currently being considered by the government as to whether they should be de-designated or not, and is one of the points that this Committee has helpfully identified in the past and the government is now pursuing that recommendation. We also price regulate NATS.

Q7 Chairman: National Air Traffic Services.

Dr Bush: National Air Traffic Services. The en route sector of that; the aerodrome elements are not price controlled, they are in a market. Then a different part of the CAA from mine, the Consumer Protection Group licenses airlines. We used to, in the economic regulation group, regulate fares and we have in the last six months or so given that up entirely now—we regard that as a market matter.

Q8 Chairman: Do either or both of you consider that British airports regulation is over- complex in comparison with other airports?

Dr Bush: I think it is not complex in one respect in that we are actually restricted to a relatively small number of airports, so we are restricted to the four airports.

Q9 Chairman: The major ones?

Dr Bush: Yes, the major airports. We are then thinking about, or government is thinking about further restricting it possibly to only two, so in that sense we demarcate very clearly that regulation should only apply where there is that potential for market power. I think then when we look at how we conduct it we very much focus on our five-yearly price control activities and associated service incentives. So, again, it is less intrusive than some other sectors. I think you could say it is complex and it is getting more complex because as we dive into the whole issue of service quality inevitably you get into the question of what does that constitute? Airports deliver a range of services to airlines and passengers and as you get into incentivising each different element of those you get quite a degree of complexity and, to be frank, in order to capture more elements of service quality this time we are actually extending the basket and to that extent adding a bit more complexity. On the capital investment side as well we had last time a system of triggers so that BAA would only get paid a certain amount of money if it actually constructed something. We are doing that this time, extending that system, and again that adds to complexity. So regulation has this tendency to move on in this way as people try to demand more of it.

Q10 Chairman: You did say yesterday in the press release that the increased charges would allow BAA to raise the standard of service provided by Heathrow and Gatwick and you then went on to say that passengers and airlines will continue to invest to improve services. Are you really saying that only if they get extra financial incentives will BAA offer the improvements in service quality?

Dr Bush: No. I think a lot of the incentives actually were rebates if they do not reach the service quality. So the service quality standards are embedded in the price control settlement, if you like, and that what would happen is if they do not reach those standards then those rebates will click in.

Q11 Chairman: It is actually minimum standards that we are talking about, is it?

Dr Bush: I would not say they are minimum standards so much as the standards we expect them to reach, and those standards will be higher in the coming five years than they were in the last five years across a whole range of indicators.

Q12 Chairman: Do you really think that your financial benefits from the incentives that you offer as a regulator are greater than the revenue to be had from more passengers?

Dr Bush: I think the two things are likely to go together. One of the problems we pointed out in our evidence is that Heathrow particularly but Gatwick as well has been capacity constrained at the terminal level—it is also constrained at the runway level but that is to be dealt with by the government in its consultation tomorrow—because of the delay in the construction of T5, and that goes back to the length of time it takes to get these projects through the planning inquiries. T5 opens in March; that will release that capacity constraint and at that point enable BAA to pursue both the increase in the number of passengers but also ensuring at the same time that service quality is maintained and, where possible, improved because again we have put in a positive incentive. So if across the airport—not just in one terminal—they can actually improve the quality of service there is a little bit more money on the table.

Q13 Chairman: You do not think that actually just improving the level of service is a good enough incentive for BAA because if they offer a better service and they get more passengers surely that in itself would bring in more money?

Dr Bush: But in a way they get their passengers in good part through the strategies of the airlines. So they have to offer good service to the airlines, they have to offer good service to the passengers and at the margin that can affect things. But what we would wish to see here is something that buttresses those natural forces that you are talking about. Of course there is an element of competition here between Heathrow and other hubs and that will affect where passengers go, but we are trying to buttress, if you like, those natural forces by offering the sort of incentives that in a private sector market you would expect. You offer better quality and you might be able to get a bit more in terms of price.

Q14 Chairman: It is just that some of us feel that if you are paid to do a job it might be rather nice if you did it without being told that it is only if you get extra money that you will actually do what you are supposed to do.

21 November 2007 Mr Martin Stanley, Mr John Banfield, Mr Harry Bush and Mr Daniel Storey

Dr Bush: Absolutely, but of course across most of the piece they will only get the money in the price control settlement if they deliver the service that is in there. So they will lose money if they do not do that.

Chairman: Mr Hollobone.

Q15 Mr Hollobone: Surely airport regulation in this country is more complicated than it perhaps might need to be because in the field of airport pricing the CAA can propose price controls, but these proposals are automatically referred to the Competition Commission, whereas other economic regulators do not have this automatic referral mechanism. We have had the case recently of course where the Commission allowed charges at Heathrow and Gatwick to be increased by more than the level recommended by the CAA. So can I put to both our organisations, Madam Chairman, that point again about the regulatory system being second-guessed by each other?

Dr Bush: I was talking about a different aspect of it, but if you are talking about the process we would absolutely agree that this is over-complicated, and with the best wishes to the Competition Commission the sooner we clear them out of the process the better.

Q16 Chairman: Did you want to comment on that, Mr Banfield?

Mr Banfield: We obviously acknowledge that this system is unique to airports of actually requiring a reference to the Commission. In our report we did refer to it as appearing anomalous. We ourselves would wish to consider various aspects of regulation on which we have had varying views from various different people during the course of inquiry before we reached a decision as to our recommendation as to what we think, if any, revisions should be made to it.

Q17 Mr Hollobone: What steps are either or both of you taking, presumably to Her Majesty's government, to get this system changed?

Dr Bush: I think the government has said that it will think about the regulatory issues that arise once the Competition Commission has finished its market inquiry because at that point it will know the market within which regulation is taking place, and there may be some what you might call technical changes of the sort we have been talking about, where instead of having the Competition Commission in the middle of the process you have it in the normal way of being an appeal body. So there may be those technical changes, but also there could be more fundamental changes saying that if you have a more disaggregated market with more competition how much regulation do you need? I suspect that is an issue that the Competition Commission will need to think about.

Q18 Mr Hollobone: Can we go back to the recent case? Why is it that the Competition Commission disagreed with the CAA over charges at Heathrow and Gatwick?

Mr Banfield: I think the main reasons were additional capital expenditure and really additions to the capital expenditure plans during the course of our inquiry, plus various additional operating expenditure items, especially on security. I am not sure that there was a fundamental difference in approach. There has now been a further revision by the CAA but again in the light, I think, to a large extent of subsequent evidence.

Dr Bush: I think we have been very closely aligned actually on the key issue, which is the return that BAA should get. Actually at Heathrow we pretty much have the same number—slightly different approaches but the same number—and the Competition Commission had only a slightly different number at Gatwick. So on that key issue two regulatory bodies have taken pretty much the same view.

Q19 Mr Hollobone: What unique challenges does BAA face compared to other operators, apart from the obvious pressure caused by increased scrutiny of it as a group?

Dr Bush: My feeling is that over the next five years, using the opportunity that comes with T5 to really drive the operating efficiency and service quality of the airport. There has been, if you like, an excuse up to now which is that the airport has been very overcrowded—both airports overcrowded. With the opening of T5 and the new investment that is being put in in this coming five years to improve the rest of the airport that excuse goes; that actually from now on there ought to be sufficient capacity to enable them to drive the sort of service quality that is needed. There will be some transitional issues in the east end of the airport as the existing facilities are refurbished, but you will have 30 million to 35 million people going through T5 on day one, experiencing that new part of the airport, releasing the pressure at the other end, which again should help ease congestion and help service quality. So over the next five years that is the key thing: to restore the reputation of Heathrow and to restore the service quality there.

Q20 Chairman: Do you want to comment on that, Mr Stanley?

Mr Stanley: I do not think so, Chairman, no.

Q21 Chairman: Mr Banfield?

Mr Banfield: No, I would agree with that.

Q22 Mr Hollobone: My last question, Chairman, is why do you think BAA needs encouraging to meet minimum standards of service? Not higher standards but the minimum standards of service?

Dr Bush: I do not think we are saying that it needs encouraging so much as that customers, whether airlines or passengers, should get what they pay for and if they do not get the service quality that is implicit in our price settlement then BAA should not get the full price; and that is what the system means, that there are rebates if service quality is not met. So of course that incentivises them to meet the service quality but it is really about saying that you get what

you pay for; we are asking you to pay more, you should get the service quality that is implicit in that. If it is delivered above that then there might be more money for that. But it is essentially about rebates.

Mr Stanley: If I could add, it would be a strange regulator, it seems to me, that says, "Here is the money that you can get for landing charges over the next five years but it does not matter what service quality." I think you have to have an aim, a target within that for service.

Q23 Chairman: I do not think we are astonished at you asking for services, we are just rather interested that this is a commercial set-up which has a reputation of being, after all, one of the most used airports anywhere in Europe and you are really still saying that it has to be incentivised to do the job for which it is normally designed. I think that is mildly unusual, do you not think; or can you think of any other institutions that have to be incentivised to do what they are . . . Perhaps I should not say that. Let us not get lost in that particular one! Mr Efford.

Q24 Clive Efford: Whichever one of you would like to answer this: what are the main indicators of a competitive aviation industry?

Mr Banfield: The CAA has done a lot of work on airlines.

Dr Bush: I will take it. We will look at a number of different elements here. In relation to the airline market and in the number of players, the degree of choice that customers have, the prices that are paid, the trends in all of those issues I think would indicate to us how competitive it is. If you look at the UK airline market at the moment—extremely competitive, lots of choice for consumers, not only of different airlines but different airline models, different ways of travelling, different ranges of destinations through a whole range of different airports. So I think that, as far as airlines are concerned, it is pretty competitive. The old constraints on some of that competition, the bilateral arrangements between countries, are gradually being phased out—we had the EU/US agreement, which is now phasing out the control that there was there, but more generally it is something like only 10% of flights will be affected from next March by bilateral arrangements of that old fashioned type. So much more choice, much more competition, less constraint from government and regulation. So that is the airlines. Airports: a pretty vibrant regional airport sector. We have recently published a report on this—we published a report last week on this which shows continued growth in the regional airport market. A lot of choice for passengers and airlines between regional airports offering different levels of service, different strategies and a lot of choice as to connections that you can make from them compared with, say, ten years ago, and indeed compared with five years ago. Not only choices of destinations in Europe but through the hubs in Europe and through Dubai and actually now direct flights to the States—connections also beyond those points. So very, very substantial choice for customers.

Q25 Clive Efford: Are the elements of competition between London airports similar to those as, say, between London airports and their European counterparts?

Dr Bush: You have a unique position in London obviously with BAA's ownership of three of the airports. We think there is interaction between those airports at the moment and interaction between the BAA airports and other airports in the system, so there are elements of competition there. We think that passengers do make choices between these airports. We do not believe that they are local monopolies in any sense; we think there is choice going on there. So there are the elements or the foundations for competition there, and around an airport like Stansted we think there is competitive pressure on Stansted from the airports around its boundary.

Mr Banfield: A main issue we will be considering is what competition there would be between separately owned airports within the London area; whether you can generalise from the example of regional airports where maybe there is more spare capacity and whether there may be other factors that could restrain competition. The Office of Fair Trading identified joint ownership as one of the features of the market restricting competition; that is one of the main points we will have to consider.

Q26 Clive Efford: For instance if Stansted or Gatwick were separated off from BAA how would that improve services for passengers and increase competition, if that is what is desired?

Mr Banfield: I think that would depend both on the ability of the individual airport to be able to compete given the amount of capacity they may have, the extent to which they would compete in developing the facilities, the extent to which passengers or airlines would switch in response to lower prices and different investment programmes. Another factor we may want to look at is the extent to which separate ownership of airports could lead to investment programmes more catered to particular types of user at particular airports. These are issues on which we have a long way to go in our investigation.

Q27 Clive Efford: Given the difficulties involved in making maximum use of runways and various issues that confront the aviation industry, do you think it is possible to have a genuinely competitive aviation sector?

Mr Banfield: Certainly doubts have been expressed to us by some of the parties from whom we heard as to whether you would get fully effective competition given capacity constraints, difficulties in securing planning permission, etcetera. On the other hand, as I say, we need to investigate whether, nonetheless, there could be an element of effective competition or even whether the position of the regulator, for example, could be assisted by an element almost of comparative competition having different managements at different airports maybe doing different things in different ways.

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Dr Bush: I think that in the London area you have some very specific circumstances around developing airports in highly populated areas and therefore I underline the point that John has made about the planning regime and planning restrictions will be an issue that will need to be thought about. Air space constraints will need to be thought about very carefully. Airports are not just about putting tarmac on the ground, they are actually about planning the airways and we have in the southeast of the UK some of the most congested air space in the world and that issue and how air space gels with the physical infrastructure of putting it on the ground is extremely important. That could be a constraint on the amount of competition that is feasible in terms of putting in new investment. So it is a pretty complicated question actually.

Q28 Clive Efford: That really brings me to the next question I was going to ask, which is what alternative courses of action could encourage the development of a more competitive airport market within the southeast of England? You have mentioned air space as one but what else is there that perhaps could create a more competitive market in the southeast?

Dr Bush: I am not sure there is a magic answer here because you cannot conjure up new airports, which is the usual way in which you would try to increase competition—it is quite difficult to increase capacity even at existing airports. Some people have talked about possibly having competition within airports between terminals as a way of increasing competition within the sector. We have looked at this in the CAA on a couple of occasions—in 2002 and 2003 and right at the beginning of this price control review—and I think we have concluded that there is not much in the London context in that idea, simply because at Gatwick you have two terminals pretty crowded and congested, and it is pretty difficult anyway to make a market just between two players, and that would be Gatwick; and at Heathrow the tendency is actually, for good network management reasons, for the different alliances to congregate in different terminals, which rather means that what you are trying to do is set up competing products for passengers rather than competition between terminals.

Q29 Clive Efford: Would it be accurate to say that airports, rather than competing with one another, actually fulfil a niche within markets within the geographical areas in which they operate?

Dr Bush: I think if you look at the regional market—and this covers the vast majority of airports in the UK—it is pretty competitive. What will happen is that they will attract passengers from the vicinity but those passengers at the margin will tend to go somewhere else if the services are not available or the price is too high, or a range of other factors. So there is competition there; there is competition between airports to attract airlines because those airlines can pretty much now, with low frills, fly anywhere in Europe. So there is a lot of competition. The question about London is does building new

capacity in a very congested, highly populated area pose special challenges which might constrain competition? I think that is the particular question.

Q30 Clive Efford: My last question is, regardless of the outcome of your investigation do you think that BAA, as we know it today, will exist in the same form in five years' time?

Mr Stanley: The answer to that has to be we will tell you in two years' time.

Q31 Clive Efford: In the interim then is there any advice or any recommendations that need to be made to BAA before the outcome of your report is known?

Mr Stanley: It is far too soon. Sorry.

Chairman: Mr Wilshire.

Q32 Mr Wilshire: If I could pursue for a moment these issues of competition—and I would also, if I can, Chairman, come back to the service quality in a minute. As a great believer in the free market it grieves me to have to accept that there is probably a case for not believing in the free market in some issues around aviation. For example, I imagine that nobody is going to argue for a competitive air traffic control choice in an airport, therefore one establishes the principle that a monopoly of some sort is bound to exist. As you said that there is good competition in this country between airlines, is it possible that the airport could sit somewhere between air traffic control—where we all agree there should be no competition—and the airlines, where you stress that there is good competition? What is actually the role of the airport in that competitive situation?

Dr Bush: Can I just make two points? First of all, in relation to air traffic control of course it is the en route air traffic control that is a monopoly, but the air traffic control that is provided at airports is competed—the contract for that is competed. So whether it is the BAA airports where they will be negotiating with NATS or actually elsewhere, there is the potential for competition and contestability in that market. I agree with you that you are looking at a spectrum from, as it were, the en route traffic control through to competitive airlines and do airports sit somewhere in the middle? In a sort of way in London they do because that is why we regulate them, and we regulate them in a different way from the way we regulate NATS—there is less in the way of licensed conditions, a lot of services specified as to what you should precisely do, and we do not have that so much in airports. So the regime is recognising that the elements of competition around the airport area has been less intrusive than, say, we would have had with NATS, and it would be true of other utilities as well.

Mr Banfield: Nonetheless, there are examples of competition between airports and, as I say, we need to see whether it is realistic to expect competition between airports within the London area and between Edinburgh and Glasgow.

Q33 Mr Wilshire: That is the next issue I want to move on to, the situation in the southeast, in the London area. If all the London airports were in separate ownership what would be the competition between them? What would they be competing amongst themselves for?

Mr Banfield: There could be an element of price competition, the prices offered to airlines; there could be competition in development of particular facilities suitable for particular types of user; there may even be an element of competition on service to attract customers. Unfortunately, yet again we are a long way from reaching any conclusion on these issues. Broadly these are the hypotheses we have to consider.

Q34 Mr Wilshire: Do you really think that another airport in London will set up a fully blown hub and spoke operation and therefore compete with Heathrow?

Mr Banfield: I think the hub and spoke operation may well be in a slightly different category. Certainly the Heathrow airlines, from whom we have heard, believe that there is no real alternative to setting up a hub anywhere else. Nonetheless, that does leave the point to point operations, which possibly are more potentially competitive.

Q35 Mr Wilshire: So if the argument goes that Heathrow southern spoke is a realistic monopoly in this country where is the hub and spoke competition—from abroad?

Mr Banfield: There would be an element of competition for transfer traffic but transfer traffic is still a minority in the Heathrow traffic, 30% or 40%.

Dr Bush: It is a minority but it is an important minority because that is the bit that can swing very easily between going to Heathrow or going to Schiphol or going to Paris or going to Dubai; and so, as time goes on, if anything there is increasing competition between hubs. And those of you who have been to Dubai and seen what they are envisaging in terms of increasing their facilities will be only too aware of just how much that particular element of competition, what difference that could make far away from the Middle East.

Q36 Mr Wilshire: But is it not the case that far from being an insignificant 30% to 40% the transfer of passengers at a hub airport would justify both short haul routes, bringing passengers in, and long haul routes for the transfer of passengers. So if you start to undermine that situation it is far from insignificant because you lose routes for other people as well, do you not?

Dr Bush: Absolutely.

Chairman: Is that a question to Dr Bush or to Mr Banfield?

Q37 Mr Wilshire: Both.

Mr Banfield: It depends how effective that competition would be. The fact that Heathrow charges are currently increasing fairly significantly suggests that competition from overseas hubs is not

actually a constraint, at least on the current price increases that are intended at Heathrow. So it is a matter of how effective competition is.

Q38 Mr Wilshire: Given the fact that there is scope for competition from hubs abroad and no scope for competition on a hub basis from within the United Kingdom, would you agree that in any proposals that come forward or any debate that takes place it is important not to harm Heathrow by domestic changes in such a way that it will penalise it when it tries to compete with the real hub somewhere else?

Mr Banfield: Those are, I think, issues that we will be thinking through. Some of that 30% to 40% I should say is domestic to international transfers at Heathrow. There may actually be an element there of competition from UK airports direct to overseas hubs as well within that.

Q39 Mr Wilshire: Presumably you would agree that it is just as easy to fly from Manchester to Skopje as it is from Manchester to Heathrow, so there is a great scope for harm, I would have thought. Can I turn to service quality for a moment, Chairman, if I may, because I think I heard somebody say that there is no excuse once Terminal 5 opens for problems? I wonder if I could reflect on that because some of the service quality issues that Heathrow faces is lack of runway capacity. Is BAA under your proposals going to be penalised after T5 opens for problems caused by lack of another runway?

Dr Bush: No. Sorry, I should have been more precise. We are very much dealing here with the passenger facing elements and some of the services to airlines from the terminal and I entirely accept that the congestion on the runways will remain until there are changes in that area, either through mixed mode or a third runway, and there will not be penalisation from that.

Q40 Mr Wilshire: Would there also not be a withholding of an incentive because of a problem in quality arising from a lack of another runway?

Dr Bush: Not from lack of another runway. We do have an element of the incentive scheme whereby if there are difficulties in the infrastructure, particularly the runway, which BAA has not put right, then actually it could suffer a rebate at that point as well. So this is not from the general congestion, from the general delay but from the fact that, for instance, if there is bad weather and they have not actually cleared the thing as quickly as they could have done then they may well suffer a penalty from that point of view. So that is to try and make sure that they manage themselves as well as they can to get the best use out of those runways.

Q41 Mr Wilshire: Presumably you will draw a distinction when you are making these judgments between, let us say, queues caused through security checking and queues caused at the check-in desks and queues caused with baggage problems?

Dr Bush: Check-in desks is an airline issue and so our proposals do not extend in a financial sense to check-in desks. What we have said in relation to check-in

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and some other services, which are much more to do with airlines, and indeed the Border and Immigration Agency, is that there should be much greater transparency of what these other entities within the airport are offering, because we are trying to incentivise BAA to operate much more efficiently and to come up with a better service, but we want to see it as part of a broader improvement of services at the airport because there is not much point, as it were, in security control being really quick and slick if queues build up at check-in and passengers do not feel that the through-airport experience is as good as they had hoped. So we want to see a much greater transparency from these other agencies about those elements as well.

Q42 Mr Wilshire: If you were to hand over your incentive and it was possible to demonstrate that the improvement had come through things done by, say, the police or the Border Agency or the airlines, would you then expect some of that incentive given to BAA to be passed on to the people who had earned it for them?

Dr Bush: I do not think that we are trying through our incentives to alter the way that the Border Control Agency or others work; I think it is much more about giving the passenger information about what they can expect at the airport. In other words, what do different airlines offer in terms of the expectation of check-in queues; what does the Border and Immigration Control Agency expect in the way of the queues at Heathrow, Gatwick and elsewhere? That is the main thing, I think, to give the passenger information and they can then make some choices.

Q43 Mr Wilshire: So are you actually saying that it is beyond your remit or you want to put it beyond your remit—

Dr Bush: It is beyond our remit.

Q44 Mr Wilshire: --- that any other improvements other than those made by BAA are something you do not even want to encourage?

Dr Bush: We want to encourage; we want to encourage the provision of information but it is outside the CAA's remit. So what we are seeking to say is: here is what we do in relation to BAA but airport operations depend on so many other players that they need to play their part in it, and we are trying to encourage greater transparency so that they do.

Chairman: Mr Clelland.

Q45 Mr Clelland: Just on this question of competition. Would a greater use of regional airports for long haul flights promote greater competition and offer a better range of services to passengers?

Dr Bush: I think over time that is what is happening. As regional airports have grown and have acquired critical mass then airlines like Continental Airlines, like Emirates, American Airlines have actually moved into these airports now offering long haul services. That helps relieve the pressure on

Heathrow to some extent, but also it actually provides people in those regions with choice because they can either interline via some of these other hubs or they can fly direct or they can go to Heathrow. So there is a variety of choices there and that is something we are very keen to encourage.

Q46 Chairman: I want to ask you a bit about the relationship between competition amongst the London airports and those that are on the continent and the European alternatives. Do you really feel that the level of charges that are proposed could compromise plans for investment?

Dr Bush: No, we do not. Both we and the Competition Commission have gone through this thoroughly and we believe that the returns we are offering are fair and appropriate and will be sufficient to remunerate the investment that is in the plans.

Q47 Chairman: Is it possible to differentiate between the viability of BAA's investment plans and Ferrovial's refinancing?

Dr Bush: That is very much what we have done. What we have done is said that our job is to regulate Heathrow and Gatwick airports and we regulating according to what we regard as a financial structure which is appropriate to those airports, and we provide fair returns on that basis. How Ferrovial goes around refinancing and financing those airports is a matter for it, and we actually have to be very clear that we are not being driven by any particular financing arrangements.

Q48 Chairman: So you are not concerned that Ferrovial's refinancing could compromise BAA's plans for investment?

Dr Bush: Our job is to provide the fair returns for the investment in here and then Ferrovial need actually to put their financing arrangements in place to deliver that investment. So it is the regulation that drives the financing and not the other way around.

Q49 Chairman: Does BAA face any unique challenges that we do not know about, apart from the obvious pressure that somebody is looking at them, and in some detail?

Dr Bush: If you look at Heathrow particularly I do not think there are many airports in the world that have been so congested for so long, and I think the pressure on that airport, both the runways that Mr Wilshire referred to, and the terminals have actually led to a deterioration in service and now trying to recover from that is actually a pretty big task.

Q50 Chairman: So is there a tension between what BAA do and what their needs are and the needs of the passengers who, after all, are the end users?

Dr Bush: There should not be because—

Q51 Chairman: That was not quite what I asked you, Dr Bush. Is there? I accept that there should not be any more than I think people should not need extra

incentives for doing the job they are paid for, but that is because I am one of those boring, old fashioned people.

Dr Bush: I do not think in practice there is because what they will need to do is put in place the sorts of service quality and investments which means that they can process the passengers. If they cannot do that then they will lose revenue, and if you look at the last few years for a variety of reasons Heathrow traffic has been flat-lining, and that is lost revenue to BAA. It is a very good example—it is not all due to what is called Heathrow hassle—of how people do have at the margin some other choices. They may be airlines making choices about different airports or about the extent to which they will put passengers through Heathrow, or it may be passengers at the margin making those choices. But it is at the margin that a company makes its money and if passengers at the margin move then BAA loses.

Q52 Chairman: Then given all the difficulties connected with Heathrow, particularly with mixed mode and the use of the runways, which are tremendously congested, do you think it is possible to have a genuinely competitive aviation sector?

Dr Bush: If you think about where we were ten or 15 years ago and you think where we are now it is much more competitive, both at the airline level and at the airport level. I think what the Competition Commission is now looking at is whether in the London area it is possible to push those boundaries further and whether that makes sense, given the other constraints in the system.

Q53 Chairman: If I asked you the question if you have reached any brilliant conclusions, Mr Stanley, I suppose you are going to rear up in horror? Would you accept that as being the general lines that should be looked at at the moment? Presumably you do not want to express any opinion?

Mr Stanley: We cannot express an opinion but this whole debate today has been all about what we are looking at and there are some very strong views on each side and there are some very interesting underlying facts.

Q54 Chairman: What would you say are the main indicators of a competitive aviation sector?

Mr Stanley: To me as a non-expert in this area the most obvious thing is that it is pretty clear that the airports at the moment, if they were not regulated, would increase their charge quite significantly, and that is what we have been fighting about for the last six months. So clearly those airports do not compete with each other in certain ways at the moment; passengers do not have as much choice, the airlines do not have as much choice as they would wish. The indicators we would like to see would be the airports responding to customers' needs, worrying about the prices they charge and so on, and that might come one day.

Q55 Chairman: I have been quite interested in what you have said, Dr Bush, about the way that you look at the elements that control the working of these

airports and the reality is that the situation in relation to all the southeast airports is changing not only all the time but at enormous speed. With the opening of the slots in London to much more robust competition, which some of us think will simply mean that you get all the large American airlines in there and everybody else will go to hell in a hand basket, what do you consider are the implications for the economic development of the regions if regional airlines can no longer use Heathrow or Gatwick in the way that they have done in the past? Is that part of your remit or is that something which is out with what you are looking at?

Dr Bush: We of course have to regulate the BAA airports and Manchester according to the laws that Parliament sets down and that does not actually have any regional dimension to it. That said, we have in the CAA over the last few years, as I have indicated, paid an awful lot of attention to what is going on in the regions and have been relatively reassured that the regions are in a much more robust position now than they were, say, ten years ago to withstand perturbations around regional routes to Heathrow.

Q56 Chairman: You do not think that that is a situation that could change quite quickly if, for whatever reason, the sale of slots, which we all pretend does not exist, continued at Heathrow could exclude regional air services. I do not care how you define it but if, for example, it is no longer possible for airlines from Manchester to get into Heathrow or airlines from Liverpool—which is a situation which could arise very, very quickly indeed once the open competition is really in full swing at Heathrow—what element of your calculation would that actually consist of? Or are you saying that because it is not written very specifically in the law you would not even look at it?

Dr Bush: We do not look at a regional dimension because that is not what is in the Act that we are given. I think there is a little bit of a corrective mechanism here in the sense that as we were talking about connecting traffic, for many intercontinental services there will need to be connecting traffic brought in. Some of that would be brought in from abroad but some of that is brought down to London from the regions. So airlines will have to balance off these different factors. Yes, these may be more marginal services but on the other hand they contribute some revenue to some of their other services. So there are some natural balances here, but as I said before the regions do have some other options now which ten years ago was not the case.

Q57 Chairman: Is there anything that you would particularly recommend to BAA ahead of your conclusions that would help it consider its future? Mr Banfield.

Mr Banfield: At this stage I think our conclusions are so far off that we really could not make any recommendations to you.

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Chairman: Mr Wilshire has thought of something.

Q58 Mr Wilshire: There are a couple things. In response to your question, Chairman, about regional routes, is it not in fact the case that Heathrow particularly has been losing regional routes steadily over the last few years and now has significantly fewer than its other hub competitors in Europe?

Dr Bush: It lost regional routes some years ago. It stabilised relatively recently but of course some of the airlines have said in response to either increasing charges or the pressure from American competition for slots that some of these services may be withdrawn. So there is always that issue.

Q59 Mr Wilshire: But having lost the obvious regional routes—and there are not any more obvious ones to lose—to say it has stabilised at the lost figure is not actually particularly encouraging, is it?

Dr Bush: I think it was Inverness that came on a few years ago, so there has been some to-ing and fro-ing as opposed to a continuous attrition.

Q60 Mr Wilshire: I will start with the press release with the question of the charges in these full and very impressive statistics and calculations which are well beyond me to grasp, except to say that you appear to have made some assumptions about the cost of borrowing in arriving at a figure for the next five years.

Dr Bush: Yes.

Q61 Mr Wilshire: Given the fact that it looks quite possible that the cost of borrowing will continue to rise and stay high for some time what happens then vis-à-vis the calculations you have done and the need to borrow to finance the improvements you say are necessary? Would you then revisit if that became the case?

Dr Bush: First of all, the Competition Commission—and their advice is what we based our proposals on—actually looked at this in September, so after the sub-prime crisis began. So that is the first point. The second is that we have actually said in our document that in view of the ongoing issue around

credit we will look again at whether there are any impacts that we should take into account when we come to our final decision in March.

Q62 Chairman: Reading your proposals, wherein you say that passengers and airlines deserve better than they have been provided with at Heathrow and Gatwick in recent years, but they need to recognise that improvements have to be paid for, I only have one final question for you. If the refinancing of the largest of the shareholder companies requires very considerable changes in the investment programme at both those major airports, would you instigate another investigation of what is happening with a view to changing the demands for investment?

Dr Bush: No. We have set out very clearly the investment programme and what we have also done through this process of putting in place what we call “triggers”, this means that some of the revenue that they get is dependent on actually undertaking the investment. So they are incentivised to go ahead with the investment otherwise they lose money.

Q63 Chairman: What is the time slot for that, Dr Bush?

Dr Bush: That is throughout the five-year period.

Q64 Chairman: So the fact that it was pushed back from an original time table would not influence you one way or the other; you are simply saying if at the end of the five years you have not done it you do not get the cash?

Dr Bush: Worse than that from their point of view; if it slips more than three or four months in relation to a timetable that has been agreed then actually they start losing money. Similarly, right at the end of the period we have said that we will revisit the programme and if it has been deferred for reasons other than good airport operational reasons we will consider clawing back some of the revenues that were allowed. So it is not an easy route out for the company to say, “We have some financial trouble, let us defer the investment programme.” We have made that much more difficult.

Q65 Chairman: Mr Stanley, were you going to comment on that? No. You were just agreeing.

Mr Stanley: I am agreeing.

Chairman: Gentlemen, you have been very helpful. Thank you very much indeed.

Witness: **Mr Simon Evans**, Chief Executive, Air Transport Users’ Council, gave evidence.

Q66 Chairman: Good afternoon. Thank you for joining us. Would you be kind enough to identify yourself?

Mr Evans: I am Simon Evans and I am Chief Executive at the Air Transport Users’ Council.

Q67 Chairman: Thank you very much for coming this afternoon. Did you have something you wanted to say to us, Mr Evans, or will you risk questions?

Mr Evans: I like to live dangerously; I am happy to start taking your questions, thank you.

Q68 Chairman: We are delighted to have you here. Do you want to tell us a little bit about the AUC’s role in the regulation of aviation in the United Kingdom?

Mr Evans: We have no role in terms of regulation because we are not a regulator. We are the Consumer Council for air passengers in the UK, funded by the Civil Aviation Authority. By terms of reference we complement and assist what they do, so in practice we try to protect passenger interests in areas where the regulatory authorities do not have any remit. So in terms of airports, for example, we

do not try to second-guess what they would say in terms of airport charges.

Q69 Chairman: That is very helpful. Mr Evans, if we could have a little bit more voice it might be kinder on your record takers. Do you think that the regulation of British airports is over-complex in comparison with other regulated industries?

Mr Evans: We have not actually taken a detailed look at that, but I think we would say that for the same sorts of reasons that you have heard from the previous witnesses there are specific circumstances surrounding the major London airports that would make us feel uncomfortable without any regulation of any description, and then if you are going to regulate and it is going to be meaningful I suppose by definition there has to be an awful lot of detailed examination of data.

Q70 Chairman: Tell me, Mr Evans, do you ever have to shout at anybody?

Mr Evans: Fortunately not very often, no!

Q71 Chairman: Could you make an exception this afternoon and pretend that you are shouting at somebody?

Mr Evans: I sound very loud to myself but I will continue to try.

Chairman: You do not sound very loud to us! Mr Efford.

Q72 Clive Efford: As a neutral observer what effects do you think that the sale of Gatwick or Stansted would have on passengers?

Mr Evans: The sorts of answers I imagine you would expect me to give would be that would set them free to compete much more straight on with Heathrow and Stansted. Of course it would depend very much on what they did with their charges and I suppose that if they were to try to attract traffic away from the others you might expect some lowering of charges; and then we would have to ask what that would mean for passenger services, standards for passengers at the airports, and indeed whether airlines wanted to use the airports and whether airlines were happy that their passengers would experience a lower level of service. It would probably be a risky strategy at the moment and it is certainly not something that we have espoused, largely because we have not done any sort of detailed examination which would tell us whether that would be the right thing to do.

Q73 Clive Efford: When you say risky, what were you referring to when you used that word?

Mr Evans: In terms of how would Gatwick take the opportunity and in terms of the service standards that might be delivered to passengers if Gatwick were to try a different strategy from its current strategy.

Q74 Clive Efford: What from your point of view is the nature of the relationship between the airports and passengers?

Mr Evans: Do they have one in terms of contractual arrangements? And the answer to that question is no, they do not, because the passengers' contractual arrangement is with the airline. Passengers want a good experience going through the airport but in a lot of the areas that we talk about as creating problems for passengers, like queue times—I suppose queue times is the main one, and you have talked about check-in queues and security queues—the interesting question for an organisation like mine in prioritising where we focus our resources is these sorts of issues that we talk about at the airports are a nuisance but the question as to what degree they are consumer-detriment in terms of our passengers potentially losing money as a result of what happens, you are making a distinction between if an airline loses your bag, for example, you have lost money. So the relationship between the passenger and the airport is an interesting one. Passengers want a good experience but they do not actually have any contractual relationship with the airport.

Q75 Clive Efford: What about BAA's airports? How would you characterise the relationship between them and passengers?

Mr Evans: I am not sure that the relationship is very different between BAA airports and passengers and any other airports.

Q76 Chairman: Have you never had any complaints about the airports? When you get complaints from travellers do they never say to you, "That is a rotten airport; it was like a rat-run and we could not move and on top if they managed to lose my bags"?

Mr Evans: We discussed that particular question in your Air Passenger Experience investigation and the answer is no, they do not, because they would have been exercised at the time by having to stand around longer than they wanted to, but then they get through their trip and if everything else goes okay they get on with it. Typically people complain to us if they have actually lost out and lost money as a result of what happened. Of course if somebody is trying to make a case for compensation from an airline they may well then put in almost collateral evidence, "By the way, we did not like the long queues at the airport." But we get very, very few complaints about airports in their own right.

Q77 Clive Efford: From your vantage point, picking up the comments from passengers, is there anything that you would in an ideal world want to see changed in BAA's airports?

Mr Evans: The main thing would be queue times. But if you look at the average queue time at security, for example, before August last year they were meeting their average targets consistently. We all know that averages can hide a few horrors so there probably would have been occasions during the period when people were going through security with no delay at all and other occasions when it takes them longer. It is the convenience issues that you have discussed with your previous witnesses—it is queue time, signposting, way finding, being able to

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get from the kerb where you have left your car or from the train station through to your flight with minimum hassle. Some people like shops, others do not. Refreshment outlets around the airports, and certainly refreshment outlets are important during delays—if you are delayed you want to be comfortable during the delay. But all of these things are things that the airports do try to provide for passengers anyway as part of the deal.

Q78 Clive Efford: Do you accept that cross-subsidy has benefited passengers in the past? Do you think that the time for cross-subsidisation of airports is ending?

Mr Evans: I would not go as far to make that point. On questions like that my organisation tends to ask the question of those who would make the decision, but I think there is no doubt that Stansted probably would not have been built when it was without cross-subsidy and that definitely was good for consumers because it facilitated the growth of the no frills carriers there, providing competition to the carriers at Heathrow and Gatwick. Whether now it would be right to get rid of cross-subsidy of course is an open question and if we accept that we need more capacity at Stansted some time in the future there must be a strong argument for saying that if you are getting good money coming through Heathrow let us spend some more at Stansted.

Q79 Clive Efford: Do you think that passengers care who owns the airport that they are flying from, or that their £1000 club class ticket might be subsidising someone else's £25 ticket?

Mr Evans: I do not think they do care who owns the airport, unless I suppose that somebody were to point out to them that a different owner might give them more of what they want. That probably would be a leading question. I think the discussion as to whether individual airports have discrete markets is an interesting one because your £1000 business traveller who flies through Heathrow on business may well be a £20 fare no frills passenger flying out of Stansted. So I think that is an argument that you need to disentangle if that was going to be the only reason for ending cross-subsidy.

Q80 Clive Efford: Engaging passengers' opinions, is it an argument that you disentangle?

Mr Evans: We have raised it as an argument that needs to be discussed in the context of the regulatory review of our regime of the airports, of the BAA London airports. We do not actually engage passengers on specific questions like that about airports.

Q81 Clive Efford: As somebody who is an occasional flier how do I know that you represent my views?

Mr Evans: We may not; you may think differently from us. But the feedback from complaints is an important source of the areas where passengers suffer detriment, things that have happened to passengers that cost them money. Where you might have a view on something like airports where you would like something done a bit better but actually you are not going to lose out, that is where we have

a Consumer Council or their passenger representatives—these are people we get by advertising in the national press and it is a model that is followed elsewhere, but we would accept that we do not represent everybody's views all of the time. We try to find a middle way through, I suppose.

Q82 Clive Efford: One last question. Are there ever occasions when you go to the CAA and say, "Your regulations and your charges are actually getting in the way of benefiting passengers"?

Mr Evans: Of the charges, no, we have not. Where we find ourselves more is in between the airlines and the airports because both would like to invoke the AUC in their support, and in the context of a 15% increase in charges, for example, which you read about in the papers in the last couple of days, that sort of issue where we would get each side telling us, "You need to support us," on that particular point we would say that 15% actually means £1.60 in real money, and if you look at how competitive and inexpensive air fares can be that probably is not going to hit us too much and maybe that is the price we need to pay for the capacity that we want at these airports so that we do not have to queue in security.

Chairman: Mr Clelland.

Q83 Mr Clelland: What feedback do you receive from passengers on the subject of competition?

Mr Evans: Again none, specifically, because it is not the sort of thing that people pick up the phone or write to an organisation—perhaps not to any organisation but not to organisations like ours. Very occasionally we will have a letter from somebody who has found that when they had logged on to a website to book a fare from their regional airport, for example, they only had one airline to choose from and they thought it was expensive. But we do not get enough of those to be able to build a thesis around what they say, and of course we answer them that this is a liberalised market and if another airline saw an opportunity to compete on the route they probably would be there offering competition.

Q84 Mr Clelland: Nevertheless, your organisation does have opinions on competition. You stated that the idea of competition within airports should not be discounted entirely. Do you think that is an idea worth pursuing?

Mr Evans: Yes it is, but the suggestion arose in the context of regulated airport charges and behind the suggestion was also an analysis of the practical problems that you may have if you do go down the route of competition within airports. So we were simply saying that we can see the theoretical attraction but I suppose behind what we were saying was, "Please do not do it until you have looked at the practical issues and do not create any new problems just by trying to create more competition."

Q85 Mr Clelland: What sorts or models of competition within airports did you have in mind when you made that comment?

Mr Evans: We were following the lead within the documents, which was principally competition between the terminals, I believe, and our comments were predicated on the knowledge that there is competition between terminals at airports around the world and people saying that that worked. But we did not feel that we were sufficiently competent to come out and say that yes, that should happen or that should not happen at BAA airports.

Q86 Mr Clelland: What feedback do you receive from passengers on the subject of airport charges?

Mr Evans: The feedback we get from passengers on the subject of airport charges is when they want a refund of their charges because they have not travelled. That pretty much is it. We do not get many calls from people saying that they do not want to pay them. Strangely enough people do accept that there are taxes and charges when they fly, and I suppose a lot of that is because the base fare can be very cheap these days. But principally the complaints we get are when they are trying to get their money back and airlines are putting hurdles in their way to prevent them having a refund.

Q87 Mr Clelland: Do you think that passengers ever make a link between their experiences and the bigger questions of competition and regulation?

Mr Evans: Inevitably some do but that may be because they have a professional interest or just a more general interest in those sorts of issues. But I would think that for the most part no. Passengers shop around for the fare they want, for the holiday or the journey they want and they take the airport experience more or less as it comes.

Q88 Mr Clelland: How do you think passengers will react to the level of charges proposed by the Competition Commission?

Mr Evans: They probably will not even notice because we will still see the deep discount fares on airlines' websites and advertising, so the perception will not be that fares are going up particularly. Members of the Committee know how complicated it is setting fares, so there will be perhaps fewer cheaper fares or some of the extra money will be loaded on the higher end, business class fares that are being paid by companies, so I do not think they will react unless it becomes very apparent that fares have gone up significantly as a result, and I do not think they will.

Q89 Mr Wilshire: Is it fair of me to have the impression that you do not actually go out and test opinion; you wait for opinion to come to you?

Mr Evans: Yes, it is, because that is not the way we work. On a lot of the areas, such as the difficulties that people experience, we do get significant feedback through complaints. One area where we did test fairly recently was some market research on the taxes, fees and charges issue: did people understand that these charges may vary in different airports and so on?

Q90 Mr Wilshire: You said to Mr Clelland that you had no feedback on whether or not people have views on competition and yet you subsequently said, when asked whether passengers linked the fare experience to competition, "Yes, some do". If you have had no feedback, if you have not gone out and tested opinion, how can you possibly conclude that some link them?

Mr Evans: I said I was sure people probably do, because those are the sorts of conversations one has with people around this, the windfall information, I suppose, or straw polling, but it would be wrong to say that people do not make any connection and wrong to say everybody does, I suppose is the point I was trying to make.

Q91 Mr Wilshire: But do you not think it would be a good idea to go and talk to customers rather than making the disgruntled come to you?

Mr Evans: We probably would if we spent a lot of time on competition issues during the course of our work, which we do not. It is not prioritised because of the terms of reference and because of our budget.

Q92 Mr Wilshire: Again, did I understand you correctly when you said you rather had the view that air travellers would look at the fare, look at the destination and simply put up with the airport experience?

Mr Evans: By and large I think a lot of people probably feel they do not have any choice. Occasionally people, of course, say that they have had a bad experience at an airport, but one of the themes that comes through the complaints that we get in respect both of airports and of airlines is the extent to which people's decisions are based on price, so, even having had a bad experience, if the next time they want to fly the best price would lead them to say, "No, I am staying away from airports", that is probably the most defining factor of their choice.

Q93 Mr Wilshire: Does it therefore come as a surprise to you to learn that since the introduction of the new security regime last year Heathrow has lost over two million passengers on the back of the experience they had and that they have chosen to go to some other airport?

Mr Evans: No, it does not surprise us, but that was a very extreme case from August last year. A lot of people did get caught up and they missed their flights. I think this is the point. Having to queue for 20 minutes but you still get through is one thing. Being stuck in the security queue and missing your flight, or perhaps not even being allowed to check in because the advice is to close the airport because of the number of people there is quite another, and, of course, there was an awful lot of publicity and people were being shown other people's experiences, and that inevitably would make people think whether they wanted to go to Heathrow, or indeed whether they wanted to fly on holiday at all as opposed to taking a ferry or a train.

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Q94 Mr Wilshire: But does not two million passengers choosing to avoid Heathrow strike you as significant rather than just a minor issue or of no great consequence, which is the impression I am getting?

Mr Evans: I am sorry if I have given you that impression. I think it is a significant matter, yes.

Q95 Mr Wilshire: So it does matter which airport and what the state of the airport is rather than that they put up with it?

Mr Evans: I go back to my previous answer. You are referring to a very extreme, very unusual set of circumstances which I hope will not arise again at any time soon.

Q96 Mr Wilshire: If you were to join me on a Sunday afternoon at Terminal 4 when it is heaving, for whatever reason, do you think those passengers are going to blame Timbuktu Airlines or Heathrow Airport?

Mr Evans: You might go to Terminal 4 and find you go through very quickly as well, so you have to take the experience as a whole. I do not deny that some people do have long queue times, but I think there is the perception thing as well because when it is heaving and there are lots of people it does not necessarily mean that it has taken a long time to get through because one would hope that the check-in desks or the security desks are manned. I go back to the previous point. The issue which is to people's detriment is what they have suffered and I am not supposing for any moment that we would not prefer to have more capacity at Heathrow. That is certainly something that we want, to expand, but the reality is that people understand what they have got and as long as they get through and complete their journey and they have not lost any money it is probably something that they will put up with if they understand the circumstances.

Q97 Mr Wilshire: With respect, Mr Evans, you did not answer the question that I asked you. I know there are occasions when you can go through Terminal 4 in two minutes; I have done it, but there are still occasions, such as a couple of Sunday afternoons when I was there, when it has been a heaving mass for hours, so the question arises, when you have a terminal full of people delayed who do you think they blame, the airline or the airport?

Mr Evans: Now at Heathrow they blame the airport because they have seen a lot of the press coverage and they know that Heathrow is a constrained airport. If they miss their flight or if it is the flight that is delayed rather than that they are having to queue a long time to get through check-in or security, they blame the airline, and that is the right thing to do because their contact is with the airline and it is the airline that has liability for any damage they have suffered as a result of their experience.

Q98 David Simpson: This question may have been dealt with in another way, but do you think passengers care who owns the airport that they are flying from or that their £1,000 club class ticket might be subsidising someone's £25 ticket?

Mr Evans: We have had that question and I think the answer is no.

Q99 David Simpson: Just one question! Very well.

Mr Evans: They do not care; they do not even think about it. The discussion that centres around the £1,000 fare passengers subsidising the £25 fare passenger is about whether you can say there are discrete markets, discrete groups of passengers using individual airports. I am not sure that you can because lots of people use more than one airport, so maybe they use a different airport for a business trip than they would use for a leisure trip.

Q100 Chairman: Mr Evans, there has been a lot of discussion on the part of the airlines, for example, about the conditions in airports. What is your view as a council of how transparent the charges should be for using an airport?

Mr Evans: The charges that the airlines pay to the airports?

Q101 Chairman: No, the ticket price that the public pay. Do you have a view as a council on whether or not it is essential that every element of that charge should be made transparent?

Mr Evans: We do have a view. The view actually is that fares should be fully inclusive and it is not really meaningful to passengers to know what the individual components of a fare are, not least because it is the bottom line they are interested in. We can be sceptical as to whether what we are seeing on an airline website is the fee in terms of the amount, pounds and pence, that the airlines pay to the airport, and sometimes we need to step out of our own environment and there are not many other consumer sectors where you have a completely itemised breakdown of what the cost is.

Q102 Chairman: I apologise if we asked you this in the last inquiry, but just give me an idea of the size of your staff and the number of letters you get per year.

Mr Evans: Staffing currently is ten, soon to be 11.

Q103 Chairman: And are mainly those people taking queries on telephones?

Mr Evans: Of necessity, yes. Of the ten, eight are pretty much full-time engaged on complaints work and we get about 6,000 written complaints a year and 7,500 telephone inquiries.

Q104 Chairman: Has that increased markedly in the last two years?

Mr Evans: Yes, since a piece of European legislation came into force in February 2005.

Q105 Chairman: Do you imagine that will continue to rise and what is the percentage of the rise?

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Mr Evans: The rise initially, from settling down, was nearly four-fold, but it has plateau'd now and it is starting to tail down a bit, so we finally can see what we are dealing with and hopefully it will not increase again but we do not know what is going to happen going forward.

Q106 Chairman: Do you need more powers to deal with both airlines and airports on behalf of the passenger and how would I know you existed if somebody like me did not tell you in a letter?

Mr Evans: Do we need more powers? I do not think we do need more powers because there are enforcement authorities to which we can go if we want some sort of enforcement action.

Q107 Chairman: So you are always successful? You do not really need any extra powers? You know exactly how to put these airlines in their place, even though they are registered outside the United Kingdom?

Mr Evans: No. You know that was not what I was saying because I was saying there are enforcement authorities whom we can approach if we want some activity, and we have approached the Office of Fair Trading recently, for example, on a number of

issues. Individual passengers can go to the small claims court to try to enforce their rights if we have not persuaded an airline, and we have a pretty good strike rate but we do not always persuade them.

Q108 Chairman: If anybody in any other form of transport said to me that a passenger who complains can go to the small claims court I would be inclined to make a fairly rude noise because that is a neat way of shifting it, is it not? What is the point of having an Air Transport Users' Council if the only information that I can give them in the end is, "Well, tough, you have to take them to the small claims court", because I could have done that before?

Mr Evans: I would only say that we do get results for a lot of passengers, and I would hope that they would be appreciative that there has been someone they can go to. I do accept that we do not succeed in helping everybody all of the time, but I do not think any other transport sectors have an Ombudsman who can make enforceable judgments. They have similar procedures to ours and they may similarly have to refer people to the small claims court if they are not successful.

Chairman: You have been very helpful. Thank you very much indeed, Mr Evans. We are very grateful to you.

Witnesses: **Mr Roger Sealey**, Transport Researcher, and **Mr Brendan Gold**, National Officer, Unite, and **Mr Paul Smith**, Aviation Group Secretary, and **Mr Dennis Burke**, President, BAA section of the Aviation Group, Public and Commercial Services Union, gave evidence.

Q109 Chairman: Gentlemen, as soon as you arrive we are going to leave you all due to the fact that we are going to have a division in a few minutes. We do not have the witnesses from Unite because they are stuck in traffic. With any luck they will be able to join us after the division. Could I ask you to identify yourselves for the record, and perhaps you will forgive us if we do suddenly rise to our feet and leave you?

Mr Smith: I am Paul Smith. I am the Group Secretary of the Aviation Group of PCS, representing members in BAA and also in the National Air Traffic Service, NATS, and the CAA. Just for completeness because they have been mentioned today, we also as a union represent immigration officers and, of course, customs staff who also work at airports.

Q110 Chairman: That is very helpful because if you upset us, Mr Smith, we will take you through every single member you have.

Mr Burke: I am Dennis Burke. I am the President of the BAA section of the Aviation Group Paul has just referred to, and I actually work for BAA.

Q111 Chairman: Thank you very much indeed. As I say, I hope that Unite will be joining us. Did either of you have something you wished to tell us before we begin?

Mr Smith: I do not think so. We have made our submission and are happy to answer questions.

Q112 Chairman: That is very helpful. Which of the challenges that are faced by BAA present the most difficulties for workers in the industry?

Mr Smith: That is a very difficult question to start off with; there are so many across the industry. To my mind it is partly the complexity of the industry and the difficulties that are associated with the fact that an airport, apart from providing a service to the passenger, has also a duty and responsibility to their safety and security. I was a little disappointed that Mr Bush from the CAA, when talking about a competitive industry, did not also make reference to a safe industry and a secure industry, because I think they are fundamentals. Clearly the challenges that are faced by BAA, and indeed other airports, as a result of what happened in August last year were significant and did have a significant impact on the passenger experience. They also had a significant impact, of course, on the staff who had to work there because they are at the forefront and interface of the anger and animosity of the passengers who are moving around. The complexity is that the airlines, of course, as we have just heard, are fundamentally the ones who provide the service to the passengers. Passengers make their choices predominantly on where the airline is going to take them, where they want to go and the price they want to pay, and yet it is similarly the airlines that are making demands on the airports about charges, about issues affecting the rapid progress of passengers through the airport, and are constantly placing pressure on keeping those charges down. While we understand the fact that

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they have to keep charges down, it is not a situation where you can simply charge any figure you want to. There is a responsibility that BAA have and other airports have to their staff, and clearly BAA has had to recruit significant numbers of new staff to meet some of the challenges it has to meet, but we are concerned that the changes that are faced have clearly had an impact on staff and the conditions they work in.

The Committee suspended from 4.00 pm until 4.12 pm for a division in the House

Q113 Chairman: Mr Sealey and Mr Gold, it is very nice to see you both. Gentlemen, before we begin would you like to identify yourselves for the record because your colleagues are way ahead of you?

Mr Sealey: My name is Roger Sealey. I am the Transport Researcher for the T&G section of Unite—the union.

Mr Gold: My name is Brendan Gold and I am the National Secretary for Civil Aviation in the T&G section of Unite.

Q114 Chairman: Thank you very much. I was asking Mr Smith, and we will come back to him in a minute, which of the challenges faced by BAA present the most difficulties for workers. Does either of you want to comment on that?

Mr Gold: I suppose one of the most direct and important challenges for the working side is, obviously, security, safety being another very important aspect of that, but the security regime within BAA airports is well documented and lots of evidence has been produced about it and a lot of commentary made over the last 12 months, but certainly it faces one of the biggest challenges that my members are engaged in, those directly employed by BAA but also all other aviation workers that have to transit through the security regime that is required.

Q115 Chairman: So it is not a particular airport faced with particular difficulties; it is a general problem which arises mainly from the security? Is that what you are telling us?

Mr Gold: I think that would be the case, but undoubtedly, because of the size and nature of the major airports, it is more profound in those areas. For Heathrow, Gatwick and Stansted there will be more of a difficulty in those areas compared to some of the smaller BAA airports.

Q116 Chairman: You said in your evidence that “many of the events which resulted in the bad publicity are outside the control of BAA”. Which particular events do you think BAA had control over?

Mr Gold: I believe that there could have been more thought brought to bear in terms of contingency planning regarding security. I am not a believer that they were able to determine all the events that have occurred since 10 August 2006, that is way beyond their control, but I think there should have been an

increased awareness by BAA about the potential threat to security arising out of the general tourism threats that we are facing within the UK.

Q117 Chairman: You did in say in your own evidence that it begs the question that because they are operating in distinct segments of the market BAA would not necessarily become better at competition if it was broken up. Why is that?

Mr Gold: I do not believe that necessarily in a regulated industry if you break up airports, as we are talking about the BAA, it will necessarily drive competition. One of the issues, of course, is that the airports of the BAA have different markets to a greater extent, although the aviation industry is more blurred now between low fare and chartered players and the legacy carriers. It is a bit blurred around the edges, it is not so distinct as it used to be, but there is still a recognition, I think, that Heathrow is much more of a major player because of the network of routes that it has acquired, whereas Gatwick is a different sort of animal altogether. A lot more chartered players are involved in Gatwick. If you look at Stansted then it is predominantly low fare operators operating out of there. There is not the same type of operation within each airport, so if you break them down you are not comparing like with like in terms of competition.

Q118 Chairman: Mr Smith, you say that investment from a large organisation with the technical expertise of BAA is vital. To what extent can a “defragmented”—and I will forgive you that word—aviation industry be competitive?

Mr Smith: I think the issue for me is around the industry as a whole. As I say, representing members both in terms of the airports but also in air traffic, we have already heard today that air space capacity is going to be an issue. There is a projection that that is going to grow year on year for the next 15 years. The airports have to be able to service that growth. There have to be the runways, there have to be the terminal buildings, et cetera. That needs to be planned, it needs to be delivered in a way that I think is coherent consistent with an integrated policy. The difficulty with merely relying on competitiveness, and, like colleagues in Unite, I do not think that the airports are necessarily in direct competition in that way, is that leaving it to the market is not going to deliver in our view the sort of outcome we want to see, and clearly it is in the interests of everyone to have efficiently run airports and efficiently run air travel.

Q119 Chairman: So why would fragmentation lead to delays in response and political conflict?

Mr Smith: Because for me it is about making sure that the airports are consistent in offering the sort of service that the airlines are looking for because the airlines are the customers of the airports rather than the passengers. The passengers come along and use the airlines but it is the airlines that are the real customers of the airports. It is important that what is offered to the airline is consistent with what is both good for the airlines, the industry, and also good for

the economy of the country and the areas that are served by those airports. They have a much wider reach than just the airport itself.

Q120 Mr Clelland: In the written evidence from Unite at section 2.20 you make it clear that you do not think that increased competition would be achieved between the London airports by divesting the group of one of its airports. Do you think increased competition is possible at all?

Mr Sealey: I think there are problems given that in a sense you are dealing in a market which is not contestable. If you are going to have competition you want something new coming in and the possibility of building a new London airport is fairly remote, to say the least, so you have to deal with what you have got and expand that. The other thing goes back to the earlier question from the Chairman. At the moment airports gain in scale because they are catering for different markets. If you sell off one of the BAA airports, say, Gatwick, Gatwick would then be competing with the other two markets, so you would lose scale within Gatwick but you would increase scope, and the question is, would the balance between what you lose in scale and what you gain from scope be equal? We think it would be less equal, so there would be a negative benefit, if you like, because you would lose on scale more than you would gain on scope.

Q121 Mr Clelland: I understand why the union might not like the idea of competition but you do not think it is possible to have competition anyway, whether you like it or do not like it?

Mr Sealey: It is possible. The question is, would there be a positive gain from competition, and their view is that there would not be a positive gain because of their argument for scale and scope.

Q122 Mr Clelland: Why do you think that breaking up the airports would demoralise workers? Is there something particular in the whole question of breaking up the airports that is demoralising or is it founded on the fact that it would lead to a loss of jobs?

Mr Sealey: Can I ask Mr Gold to answer that?

Mr Gold: It is very clear from where we are standing as a trade union that we have a clear interest to protect our members' terms and conditions of employment and job security. That is our function, that is our responsibility. We would be failing if we did not address that and make sure that that position was made very clear. We were also drawing from experience when we made those sorts of comments, experience of working and being involved in the aviation sector with the membership that we have. We have seen that competition between, for example, ground handlers, has not in our view served the airports and the infrastructure well.

Q123 Chairman: Why, Mr Gold?

Mr Gold: Let me draw a position for Gatwick if I may. There are a number of handling agents dealing in Gatwick and we have seen the addition of another company called Menzies, with whom we have a

relationship and we work well together, but we were not keen to see another handling agent come in to Gatwick which not only reduces our members' terms and conditions because of the competition that exists driving down prices and contract prices with airlines, but also has a direct result of more kit and equipment on the ramp in a congested area anyway, and therefore has a potential safety implication. There would be more competition driving our members' terms and conditions of employment, which we have directly seen in those sectors, so we draw that parallel with where we would be within the BAA airports should one or more of them be sold off. We would undoubtedly see increased competition, increased threats to our members' terms and conditions of employment, pensions being one of them, which we are very keen, as the trade union movement always is, to protect and where we have existing difficulties with BAA on that particular issue. We have a very clear position on trying to protect people's terms and conditions of employment, that is our job, and we see without question that if an airport were to be sold off that would be an additional threat to those terms and conditions of employment and job security.

Q124 Mr Clelland: Would there not perhaps be potential for improved morale if the airport was not part of such a large group?

Mr Gold: That is not what we are picking up. That is not the way that we view it and that is born from direct experience of our shop stewards in all the different areas and all the different committees that we get involved in, bringing in the different occupational groups from across the seven BAA airports. They have had an incredibly difficult summer because of all the security regime that has been in place and the other complexities of the operation and the overload, particularly in passenger numbers at Heathrow, so they are having a very difficult time at the moment, their morale is not great, and certainly the prospect of an individual airport being sold off is seen by our membership to be very threatening indeed.

Q125 Clive Efford: Mr Gold, there is competition that is unavoidable, for instance, from European competitors. Is there anything you can tell us about whether competition from airports outside the UK has had an impact on your members?

Mr Gold: I think we are seeing a lot more of that developing, if I may say so, because of the differential security requirements in the UK compared to what we have seen in Europe and the issue of the one cabin bag, which hopefully there is going to be some movement on as a result of the Secretary of State's statement at the beginning of this week. That is undoubtedly causing a lot of the transfer traffic which would normally go through Heathrow diverting into Munich, Frankfurt, Charles de Gaulle and other airports. That transfer traffic is directly linked to the premium business traveller, and once you start losing those travellers to the hub of Heathrow and they transit through another airport and find it easier to do that as long

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as the route network is available for them to do it, then it is very difficult to get them back. We have had experience and very clear information that that has been happening since August 2006. Hopefully, with the changes to the security regime and new technology coming in we will bring those passengers back, but there has been a loss to UK plc as a result of traffic moving away from Heathrow to those other EU airports.

Q126 Clive Efford: In terms of the response of BAA to the heightened security concerns is there any way in which the size and scale of the organisation has made it difficult for it to respond to those pressures?

Mr Gold: I do not believe so, no. I think there has been incredible difficulty for BAA in recruiting new staff. They have been trying to do that consistently over the course of the summer to hit the peak workload of August and September. They have found it very difficult. Heathrow, for example, is a very tight employment labour market. It is very difficult for them to get people of the calibre they need, because the whole nature of security in the airports is changing. It is not just processing people through the archways and central search now. It is more personal contact with the passenger to be able to communicate what is required, where you put your laptop and so on. All these things mean that their function is changing. New technology is driving changes to their job and their requirements, so when you are trying to recruit you are recruiting in a very specialised area, and individuals have to go through CRCs, criminal record checks, and for the security staff a counter-terrorism check as well. That all takes time and people drop out during that sort of process. They have found it very difficult to recruit in those key areas during the course of the summer and, as we say in our submission, the requirement to have women security guards to do the proper task that is required in a sensitive manner is making it difficult for them to recruit for those areas specifically as well.

Q127 Clive Efford: So you would not say that the fact that BAA has to respond right across the network that it controls limits—

Mr Gold: Yes, I think they have responded in the right area of recruitment. Am I satisfied that their employment policies do not prevent a more progressive intake? Yes, I do think some of their employment policies are a little old-fashioned. They do not take on and engage in terms of crèche facilities, which I think they should do, particularly if they are employing women guards. There are areas of quality of work and flexibility of work which I think they need to take on in a bit more of a progressive way and which other employers in the airport have done, so there are areas like that which I am critical of and I think if they were to take on board those sorts of initiatives and have a broader thought process about how to recruit and engage people they could be a bit more successful.

Q128 Clive Efford: So you do not think their monopoly position allows them to dictate terms and conditions?

Mr Gold: I do not allow them to do that.

Q129 Chairman: I want to ask you about some of the very interesting things that you have put in your memorandum, and I am going to come to you in a minute, Mr Smith. In fact, Mr Gold, you argue that certainly in financial matters what is important is stability, and you give very clear views on why you think in effect selling off one London airport would destabilise the industry. Do you want to expand on why you think that would increase the cost to passengers?

Mr Sealey: I think it really goes back to when they were taken over. When BAA were taken over there were a number of options being floated at that time, one of which was splitting up BAA. We think that the current owner must have taken that scenario into account when they purchased BAA. If you were doing your calculations on something like that you would have to assume the possibility of the sale of one airport, perhaps Gatwick, and if that were the case it is fairly obvious you would make a profit on that but you would then have competition between them, and if you introduced competition the question is, does regulation then stay in place? We think the argument for price regulation through the CAA would be considerably weakened by the fact that it was sold off.

Q130 Chairman: Are you convinced that no proper cost benefit analysis of a break-up has been undertaken?

Mr Sealey: Yes.

Q131 Chairman: Do you believe that the high sunk costs that you identify, which already constitute a barrier to entry of new applicants, would continue to rise? Is that your argument?

Mr Sealey: It is not that they would continue to rise but if you are going to introduce competition you need a competitive market, and the problem is that with high sunk costs that is a barrier to entry, and the other barrier to entry will be the planning side. Would it be possible to build another airport in the south east? Given the length of time it took to get planning permission for T5, I think I will be well in my grave before a new airport would get planning permission.

Q132 Chairman: On the economics of BAA, in your paragraph 2.22 you talk about the long-term credit rating of BAA with Standard & Poor's and how they have lowered the rating of BAA two notches from A to BBB+ because the recommended bid meant that the risk of BAA taking on much more debt had been greatly increased. Is your view then that for that very reason it will be more difficult for them to look forward to expanding the investment and keeping that with the plans for better services at London airports?

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Mr Sealey: The problem that the debt ratio increased because they borrowed heavily to finance it means that clearly they are having to pay more money in terms of interest. Therefore that will mean that there is less money available for investment.

Q133 Chairman: What do you say to the argument that was put to us before you arrived that in fact there is not a problem because the regulator has laid down a series of hurdles in effect so that would mean that BAA would not receive extra money unless it had invested in the timescale and in the way that it was being asked to do? Is that not sufficient protection?

Mr Sealey: I think you have to ask yourself what the position would be of the shareholder, given that it will have alternative investment strategies placed before it. Would the BAA with a restricted return be the most favourable investment that it faces? If it is not then it will invest in other areas, so therefore the investment stream may be reduced.

Q134 Chairman: I see you are a bit wrong about the Committee but we will allow you that, but is it your view that we should not break up London airports because of the impact that would have on aviation in general? You also quote the view that London needs a massive and impressive airport and that that is directly involved with its economics. Is your argument that changes in the status of the airports within the London area would directly affect both investment and the quality of work or is it simply that you are looking at it as a question of value: if you break the airports up into three they are worth more than if they remain part of the group?

Mr Sealey: I think our argument was saying that no, there was the possibility that three individually would be worth more than the entity at the moment.

Q135 Chairman: Why should that then damage investment?

Mr Sealey: Because, whereas before BAA was an entity in itself and it made its decisions on its investment itself, it is now owned by somebody that has wider interests and BAA is part of it, and, given that any financial person would look at what is the return on this investment, what is the return on that investment, and if the terms of investment in other projects that would be invested in by the major shareholder would be more profitable, you would have less reason to invest in the BAA.

Q136 Chairman: But would that be offset—I ask you again—by the fact that we are told that BAA would not receive extra sums of money unless it could demonstrate that it had in fact complied with the investment plans that had already been made clear? Is that not sufficient protection because the argument you are making is that a large and powerful shareholder interested only in the return on money invested would not be prepared to carry forward the programme that might be in the interests of the United Kingdom?

Mr Sealey: Yes, that would be our position.

Q137 Chairman: I want to talk if I may to PCS about some of the things that you have said in your evidence. You very specifically said, of course, that where service providers' approaches conflict, because also when you are talking about passengers who say it is not one kind of authority, it is two, the differences in the way that the airlines react has a deleterious effect upon the passengers' experience and they then take it out on the airport staff (you have not put it quite in those terms but this is pretty much what you say). Do you think this has become worse and do you think the responsibility for that and the security lies wholly with BAA or with the Government for the security plans that they have demanded?

Mr Smith: I think it is the extent to which the airlines have responded to those challenges, because clearly BAA (and indeed the other airports) have to recognise that they must undertake the appropriate levels of security checks, they must ensure the appropriate levels of security that apply as per the directives from government. I do not think that airlines have necessarily recognised the challenge that that presents in making sure that passengers move through the airports effectively and efficiently. I do think there is a recognition by people that if they pass through an airport there is a level of security. They want to have confidence in that security process, they want to feel secure when they are boarding a plane at an airport in the UK or anywhere in the world, but there is a price to be paid for that because of the peak periods where there can be huge numbers of people passing through the airport, huge numbers of people wanting to get through to their aircraft. I think the airlines must play a role in that. The way in which the airlines operate is very different from the way in which airports operate. It is almost a completely different industry but part of the same industry. There is competitiveness between the airlines. In fact, within an airline there is competitiveness on seat prices. You can be on the same plane. You do not get there any quicker if you are paying three times the price because you have booked late or with a flexible ticket. Indeed, I am sure there are some airlines that will bring planes across or down to London where people are paying way over what it is costing that airline to fly that plane because they recognise that people do not have the choice; they need to move. They have a responsibility to recognise the challenges that the airports have and airport staff have in making sure that we maintain the high levels of security and safety and that the professionalism that exists within that security process is maintained as well.

Q138 Chairman: You have specifically said that BAA has already lost a great many properly trained and experienced staff and that there is the suggestion that a thousand more jobs will go, and you are suggesting this will have a direct effect on the quality of experience within the airports for the passenger. Is that your view?

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Mr Smith: We have certainly felt that the change programme that was implemented by BAA and the impact it had on PCS members meant that a large number of people went who had a significantly wide range of skills, experience and expertise in an airport. No employer can staff itself to meet the sorts of challenges that existed on 10 August, but having and maintaining built-in employment practices for valued staff who have a wide knowledge and experience of the industry gives you a degree of flexibility, which the BAA have seen diminish, I think, over a number of years, and that does have in our view potentially a direct impact on the passenger.

Q139 Chairman: So you are saying in effect that if there are a thousand more jobs to go just at a time when BAA is being required to become more proficient and make the experience of moving through the airports a better one you would expect it to get worse?

Mr Smith: Some of those jobs are not going to be front-line, if you like. They are the support services and back-up jobs, the financing, the resources and elsewhere, but obviously they are important for the staff who work for BAA. This is one of the great challenges that there is in a market-driven environment. We are seeing some of those same issues and challenges in the National Air Traffic Service, NATS, where obviously in a privatised company there is an issue about how you identify and make sure you can meet the investment challenges, the cost saving challenges, and that does ultimately have an impact on the staff. I understand and heard earlier what they were saying about if BAA does not meet its targets they will not get the money, but the people who will suffer from that, of course, quite often are going to be the staff whom they employ and who have to try and pick up the pieces sometimes in a very difficult environment that is not helped by some of the regulation and is certainly not helped by the way some of the airlines operate.

Q140 Chairman: You specifically mentioned the year-on-year growth targets of 3% and say that they are already factored into the investment strategy and they cannot be sustained if there are insufficient runway and airport facilities to cope with that proven traffic. Is it your view that the restriction on capacity will see us losing out as a country to investment and job opportunities?

Mr Smith: I think we have a distinct advantage from the growth in the airline industry and indeed other transport industries in this country, and clearly if we are constrained in the extent to which that is able to grow that will have a direct effect not only on those working in the industry but on the wider economy as well, and that is something that we need to address because the way the issue is being addressed at the moment seems to be very piecemeal, and in terms of the issues around Stansted and its extra runway, the issues around Gatwick and its third runway and the fact that Luton has just decided not to have a second runway, the question is, is that in the best interests of

the British economy and is that in the best interests of the country as a whole? I think that that is a debate. That is what I mean by, to use that word again, the defragmented (as yet) industry but the wider transport industry as well.

Q141 Chairman: Are your concerns covered by the press release from the CAA yesterday? Do you think they have answered your question?

Mr Smith: I have seen the article but I have not looked at it in detail, so I could not give you a thorough answer on that.

Q142 Chairman: Let me ask you finally, because I think it is important, do you believe that changes in aviation, for example, the re-sectorisation that is going to come up in the beginning of next year, are being sufficiently considered in relation to the commercial decisions of breaking up or allowing existing patterns to continue? Will that have an effect upon the investment patterns and the development of various London airports?

Mr Smith: I think it will have an effect. I am concerned that the market forces, if you like, the reliance on believing that a monopoly-regarded situation is wrong within London, will cover some of the other challenges we have within the industry and I think that is going to be to the medium and long term disadvantage of the industry as a whole.

Q143 Chairman: Mr Gold, do you think your members are being given sufficiently high quality training and support services to deal with the constant pressures?

Mr Gold: I am never satisfied that they are, to be honest, but in respect of the BAA their training of security guards is very good, very thorough. I would tend to agree with my colleague from PCS that the change programme that they have introduced and the loss of real jobs in that sector of supervisory and other managerial jobs does have an impact upon the ground level jobs of our members in security, and we are getting reports from our members in security that they cannot normally speak to the supervisor because the supervisors are doing other jobs which have been handed down because of other managers leaving the business. It does have a trickle-down effect and causes difficulties from our side.

Q144 Chairman: So what would you expect? Would you expect the level of expertise in security in the next year in our major airports to get better or worse?

Mr Gold: It sounds a bit awkward, but it will be different. It is hard to say whether it will be better or worse. I have a very clear view that the fact that the Department for Transport has been putting in a very intense security regime as required because of intelligence that comes to it is necessary. We have to trust that that is the case and we have to believe that BAA is equipped to train people in the new techniques that are required within security together with the new technology that is coming on stream to assist that process as well, which is very important if we are looking to some of the changes, such as with

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the two cabin bags that are going to come in hopefully from 7 January next year and improve the workload and speed of traffic through the terminals by the passengers.

Q145 Chairman: Finally, Mr Smith, is it your view that it will get better or worse?

Mr Smith: I think it is very difficult. I am concerned that some of the other pressures are not going to help it get better, but, like Unite, we recognise that there is a large number of very professional, very dedicated staff working there, many of them our

members, who are desperate to do the sort of job they want to do and improve the experience for passengers, and we have to make sure that the policies both by BAA and indeed by the airlines help them do that, not hinder them.

Chairman: Gentlemen, can I say thank you to you? Thank you not only for coming but also for the quality of the evidence which I think has been extremely helpful and has really put a lot of the problems into a wider context. Thank you very much and I hope in future we can perhaps lend you bicycles so that you can get here.

Wednesday 28 November 2007

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Clive Efford
Mrs Louise Ellman
Mr Philip Hollobone
Mr John Leech
Mr Eric Martlew

Mr Lee Scott
David Simpson
Graham Stringer
Mr David Wilshire

Witnesses: **Dr Paul Ellis**, General Manager, Infrastructure Policy and Economic Regulation, British Airways plc, **Mr Toby Nicol**, Communications Director, easyJet Airline Company Limited, and **Mr Don Langford**, Managing Director, Services—Europe & India, American Airlines Inc., gave evidence.

Chairman: Members having an interest to declare.

Mr Martlew: A member of Unite and GMB.

Graham Stringer: A member of Unite.

Clive Efford: A member of Unite.

Chairman: A member of ASLEF.

Mrs Ellman: A member of Unite.

Mr Wilshire: Chairman, I have never settled whether or not I do have a declarable interest because parts of Heathrow are in my constituency and significant numbers of employees of more than one witness today are my constituents, so I declare it.

before the Committee today, easyJet Director said there is a case for urgent reform,” and then there is a long quote from you. This is, frankly, not acceptable. In the worst possible cases we then have to decide whether or not we intend to take evidence from you. We have, however, discussed this. We are extraordinarily unhappy. Have you any comment you wish to make?

Mr Nicol: No. Thank you very much for pointing that out and thank you if you continue to take evidence from me, and apologies.

Q146 Chairman: Mr Wilshire, employer of the whole of BAA! Gentlemen, I am going to ask you, if I may, firstly to identify yourselves for the record. Some house rules for those of you who have not been here before. The microphone in front of you actually records your voice but does not project your voice, so I am afraid you are going to have to speak up, and if you want to catch my eye I would be very grateful if you did not repeat something that somebody has already said. Sir, would you like to begin the identifications?

Dr Ellis: Thank you, Chairman. I am Paul Ellis and I am General Manager of Infrastructure Policy and Economic Regulation with British Airways. We are the largest single customer of BAA and so we have a deep interest in the proceedings.

Mr Nicol: Toby Nicol, Director of Corporate Affairs and Communications at easyJet.

Mr Langford: My name is Don Langford. I am the Managing Director of Customer Service for American Airlines for Europe.

Q147 Chairman: Gentlemen, I am afraid I have an unpleasant duty to perform. The *Evening Standard* today has come out with an article which frankly causes us very great concern. People who give the evidence they intend to give to a Select Committee to another party, and particularly to anyone in the Press, before they arrive are actually committing a contempt of the House of Commons. The reason why you are asked to come here and give evidence and the reason why we decide what we will do with that evidence is that it is a duty of those who appear here to understand that we are a Select Committee and the House of Commons examines that evidence. I must say to those who are quoted, in this case Mr Nicol, it says: “Speaking ahead of his appearance

Q148 Chairman: Did I hear a particular word?

Mr Nicol: Apologies.

Q149 Chairman: Good. Thank you very much. Now, then, gentlemen, do any of you have anything you wish to say before we begin? No? Then you all are customers of BAA. All of you in your written evidence have made various comments about poor service. Can you give us some examples of the kind of poor service you experience from BAA?

Dr Ellis: Yes, Chairman, we can give some examples of the poor service that we experience from BAA. I think it would not be a surprise to the Committee to hear that we have had poor service in respect of the management of security at the BAA airports in the most recent year or so. This applies both to passengers leaving from the main departure halls, but also those transferring, and indeed other elements of the service. We also have poor service in terms of the number of passengers who can get on and off the aircraft without travelling on a bus. We are seeking to remedy that. Clearly, we have poor service in terms of punctuality and we are looking to an expansion of the runway capacity, particularly at Heathrow, to be able to remedy that.

Mr Nicol: I think our main concerns would fall in the area of security. Clearly, in the run up to and after 10 August last year the issue of security, how long it takes to get through the security checks at airports, has been a major, major focus and we have been very disappointed in the way in which BAA has responded to that. Whenever we go out and speak to our customers one of the major things which people say is putting them off air travel at the moment is simply the airport experience. It is not the airlines or

anything to do with us, it is the service which they are getting from BAA, specifically going through security, so most of our concerns fall into that area.

Mr Langford: I would also echo those problems. We have issues with security through control points and not through just the passenger points of the airport. We have had very significant operational problems with the difficulty of moving flight crew, goods and cargo through the control posts, which is not as obvious a problem but is still very significant for us operating at the airport.

Q150 Chairman: Can we have a little detail on that? Difficulty in moving crew through the airport. What does that mean?

Mr Langford: There is a number of control posts which bring people airside at the airport. Our flight crews come in on a bus and they have to stop at the control post to be screened before they are able to then come to the aircraft. There have been very significant delays at a number of these posts. Our flight crews have waited in excess of an hour on many occasions to clear these posts. Therefore, they report to the aircraft late for duty, which has caused us hundreds of security delays over the past year in dispatching our aircraft on time. We also have delays in air cargo going onto the airfield and these delays are quite significant, although they are not quite as photogenic as the customer delays that we have all spoken of.

Q151 Chairman: All of you must know that the security rules are laid down by TRANSEC, which is a bit of the Department for Transport. What is British Airports itself doing wrong? Where is the gap between what BAA is doing and what TRANSEC tells them to do?

Dr Ellis: The gap is in terms of the contingency planning for security disruption and having sufficient fallback potential to be able to deal with that disruption.

Q152 Chairman: In what sense, numbers of staff, the training of staff, how precisely? I must have, I think, some clear indication of what the problems are.

Dr Ellis: The numbers of staff, particularly staff who can be called upon at short notice to beef up the arrangements. In British Airways, for example, we have staff who are prepared to come into the front line when there is disruption and I think there is a need for those types of provisions to be made within BAA. Clearly, we need a more flexible arrangement in terms of the infrastructure within the terminals to be able to expand the provision of lanes and bring additional equipment into use should the need arise.

Q153 Chairman: Mr Langford, with your delays on your staff, are they delays because the security staff are not available or because there is a queue of other crews at the clearance points, or because there is some delay? What is the reason?

Mr Langford: I think fundamentally it is mismanagement of the resource. For example, when we speak about the control posts, there is obviously a great deal of construction and we are mixing many

different kinds of goods through the airport. We would like to find a way to be more efficient, to have crews perhaps to be processed outside the airport, to have lanes dedicated to crews. So you might have a crew bus and a truck delivering a bunch of magazines or something, and some things are not time-critical. Crew leaving on a noon flight is time-critical; the delivery of magazines or the delivery of construction supplies might not be time-critical and I believe these are not managed effectively, which is what is causing very specific operational problems for us.

Q154 Mr Hollobone: To American Airlines: you stated that BAA ignores Terminal 3, allowing it to decay to the detriment of BAA's customers. What evidence do you have that the condition of Terminal 3 is adversely affecting your business?

Mr Langford: We do a number of customer surveys, we speak to our customers and we have had a number of focus groups and a number of written surveys, and our customers tell us very consistently of their dissatisfaction with the facilities they see at Terminal 3 in terms of the physical environment, in terms of the walking distances, in terms of the wait times, and just a walk through Terminal 3 could show you peeling paint, missing light bulbs, Duck tape on the floor, all manner of very, very poor housekeeping in our terminal.

Q155 Mr Hollobone: In your written evidence and again before the Committee just now you have spoken of BAA's "mismanagement" of Terminal 3. When you say "mismanagement" do you really mean not treating it as a priority?

Mr Langford: I accept that the resource is finite and I accept that there are only so many things that can be done at a given time, but I believe we are not focusing on the things that are important to the passengers, for example just simply the provision of lighting, the provision of heating and air conditioning, the condition of toilets and carpets and finishes. I believe these things are not being managed properly and focused on appropriately, to the detriment of the customer experience at our terminal.

Q156 Mr Hollobone: You claim that cross-subsidisation is unfair to those airlines which pay high airport fees at Heathrow and Gatwick and also unfair to their customers, only to see that money invested elsewhere, but last week the Committee heard from the Air Transport Users Council, who argued that passengers do not really care where their money goes as long as they get to their destination on time and without hassle. Do you have any evidence that your passengers are particularly bothered by cross-subsidisation within the BAA group of airports?

Mr Langford: I think they are bothered by the net result of such cross-subsidisation. I believe if there is money that could have been spent to improve the customer experience at Heathrow which is used to

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subsidise projects at other airports, then our customers would care that their money is not being used to improve their own experience.

Q157 Mr Hollobone: Does not cross-subsidisation happen throughout the aviation industry, for example by using revenues from more expensive tickets to offer cheaper tickets to other travellers?

Mr Langford: I would say that fact is true, yes, although I do not know if cross-subsidisation would be the phrase I would use for that.

Q158 Chairman: That may just be because you do not like the English, like the rest of us!

Mr Langford: I am quite fond of the English, Chairman.

Chairman: Cross-subsidisation, Mr Hollobone.

Q159 Mr Hollobone: Just some questions to easyJet: easyJet has complained about the level of investment at Stansted. Would you accept that lack of investment at Stansted is a problem faced by all airlines?

Mr Nicol: Our problem at Stansted is the level of future investment which is being proposed, dealing with a move from 25 to 35 million passengers on the one hand or what is called the SG2, the second generation of the Stansted development due to come on-stream in 2014, give or take. The level of investment which is currently there at the moment we are wholly satisfied with. There has been no cross-subsidisation certainly for the last couple of quinquennial reviews into Stansted. It has been seen as a stand-alone airport, and that is absolutely right in our book. Our problem is the future development, particularly being unfit for the kind of airlines that operate through Stansted.

Q160 Mr Hollobone: Do you maintain that Stansted is unfairly subsidised at the expense of Heathrow and Gatwick?

Mr Nicol: No, absolutely not.

Q161 Mr Wilshire: Could I just go back to American Airlines' response to my colleague's question about the impact on your business of T3? What in fact you did, I think, was to rehearse the problems which any of us who use the airport are horribly aware of. Could I press you a bit further? What evidence do you actually have that that has damaged your business, as distinct from simply upset your customers?

Mr Langford: We have seen, with our customer flows to points beyond Europe, that Heathrow is becoming a less popular transit hub and we are finding that customers are making their transfers at other airports within Europe, and we believe this to be a trend which is continuing.

Q162 Mr Wilshire: In what sorts of numbers? Have you any figures?

Mr Langford: I really could not provide any numbers to the Committee at this time.

Q163 Mr Wilshire: Can I ask the same question of our other two witnesses? What evidence do you have of impact on your business as distinct from unhappiness?

Mr Nicol: From easyJet's perspective, I think at certain airports you have to sell tickets more cheaply at certain times in order to fill the aircraft, it is as simple as that. When, as I mentioned earlier, all of our passengers tell us that one of the biggest hindrances to air travel is the airport experience, particularly the length of time it can take to get through security—and I am principally talking here about Stansted and Gatwick because easyJet does not operate from Heathrow—going through those airports, it is difficult. People will say, "I'll fly but I'm going to pay £5 less to do it," and that has an impact on our business.

Q164 Mr Wilshire: I cannot resist the temptation to say that is beneficial to the customer, but I do not think we ought to pursue that thought too far.

Mr Nicol: I do not believe that spending an hour in the security queue is particularly beneficial. I think people would prefer the certainty to know that it is going to be ten minutes and no more than ten minutes.

Q165 Mr Wilshire: I do not disagree. Dr Ellis?

Dr Ellis: I think there are two areas where we have particularly noticed the adverse impact. One is in terms of the transfer of passengers, and we have some evidence which we have submitted already to the Competition Commission about that, which I would willingly submit to this Committee as well. Secondly, we have evidence in relation to the effect on business passengers who would normally take short-haul trips who are avoiding Heathrow. We can see that very clearly in the trends that we were seeing in our business up until August of last year and those which happened subsequent to August last year.

Q166 Chairman: Dr Ellis, you are talking about business passengers moving from you to other airlines? Is that what you are talking about?

Dr Ellis: I am talking about British passengers moving away, certainly from us. Some would go perhaps to other airlines, some would choose not to fly and some would go to another airport. It is a mix of factors. We can track what happened to our business as a result of the impact of the security restrictions.

Q167 Chairman: What element of that is reflected in price? You now have competition from other airlines who offer business class facilities for much less than some of the prices you have asked for until recently.

Dr Ellis: Yes, we do. What we do have evidence of is that people were prepared to pay those prices to travel from Heathrow because of the benefits that Heathrow brings, but the additional burden of having to go through long security queues has clearly dented that business. It would also have an

impact, of course, on our costs in terms of managing the implications of the long security queues, so it is a two-way thing.

Q168 Mr Martlew: Just on that, has the situation got better with regard to the security queues? I went through Stansted on Saturday morning and there was not a problem, so are things better than obviously they were in the summer?

Dr Ellis: Yes, there have been some improvements, but we have a long way to go, particularly in terms of the transfer of passengers, where they are still facing very long queues and indeed BA¹ are currently seeking to defer the implementation of the recommendations of the Competition Commission in terms of dealing with those transfer security queues and indeed the control post queues which we heard referred to earlier. We are, of course, looking forward to further improvement earlier in the New Year when the “two bags” rule starts to be amended.

Q169 Mr Wilshire: Our witnesses are three amongst probably hundreds of thousands of people who had good reason to moan about things, particularly at Heathrow. Could you tell us something about how you have found engaging with BAA to discuss those problems and what impact you have been able to have on getting things improved?

Dr Ellis: I will take the lead on this one. Under the auspices of the CAA there has been a process called “constructive engagement” between the airlines and BAA, both at Heathrow and at Gatwick. That has led to a richer sharing of information in some areas. In some aspects of the capital programme, for example, we are doing better on those. However, we are now at a point in the regulatory process where we can see that some of the investments we felt had been agreed through the constructive engagement process are now being reviewed and rolled back when it actually comes to the crunch in terms of the triggers which are being put on those investments and the reward that would flow to BAA. So we are part-way through a process. We have yet to see whether it actually produces the goods because with constructive engagement we can only in the end determine its success when we see delivery on the ground.

Mr Langford: May I say, in terms of on the ground operationally, I believe that over the past few years BAA has actually been less responsive to operational issues. I believe we had much more coordination with BAA and with the leadership at the airport terminals to handle operational issues and forecasting problems. I believe the focus has gone away from that and I do believe there needs to be some significant improvement in those areas.

Q170 Mr Wilshire: Before Mr Nicol answers, could I ask you when you noticed that change and why you think it happened?

Mr Langford: On the first part of the question, I would say over the past few years our access to senior leadership and our regular operational

coordination has certainly deteriorated. I cannot comment as to why, but a number of people have departed BAA and their successors have not re-established those operational links as we had in the past.

Mr Nicol: We have been involved in the constructive engagement policy at both Gatwick, where it has worked very well, and Stansted, where it has worked appallingly, such that Dr Harry Bush, whom the Committee heard from earlier in its inquiry, effectively is proposing to de-designate Stansted for price control reasons, which we think would be terribly damaging to the customer. One of the reasons why the constructive engagement process broke down was despite many, many calls from the airlines, principally the ACC which looks after the airlines’ interests at Stansted, for particularly business plans, financial numbers and passenger numbers upon which its infrastructure investments were going to be based, we could not get that so we were unable to assess whether their passenger forecasts and their capital expenditure plans were appropriate. As a result of that, the constructive engagement process has broken down, much to our great annoyance.

Q171 Mrs Ellman: British Airways in the written evidence say that BAA “has no incentive to promote vigorous intra-group competition, but instead has sought to manage the airports on a ‘systems basis’.” How exactly could that be changed? Could it be done through changes in the regulatory regime?

Dr Ellis: Yes, I believe it can. It is a big question. If you had asked me that a year ago, I would have probably said that we needed to split the airports up so that each operated independently. There have been some glimmers of hope over the last year. There is a number of factors which have changed, of course. We have had the Ferrovial take-over, we have had the Competition Commission inquiry in progress, we have had the quinquennial review going on, but we have seen from BAA a move towards paying much more attention to its key asset, which is Heathrow, and we have been very pleased with the way in which they have now come on board and are leading the campaign for additional runway capacity at Heathrow. We believe that is a very important step forward. What we are not sure of, of course, is whether that momentum would be maintained when the spotlight moves on, and I think it is an important question to address, which we are certainly taking up with the Competition Commission, to see whether we need to change the regulatory structure if we do not go through, if you like, the end game of going for a full break up. We think there are some important changes which potentially could help through the regulatory structure being amended. If I could give you an example, if we went for a much more conventional arrangement where we had licensing of BAA (which applies to other regulated industries), if we looked very much more closely at the duties of the CAA, which of course are now being investigated following on from a recommendation of this Committee, and if we looked at those duties which

¹ Note by witness: Delete “BA” insert “BAA”

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we believe the CAA is interpreting far too leniently and flexibly in terms of the conditions it sets for BAA in terms of its price mechanism and in terms of meeting service quality, and if we get that to be tougher, then there may be a way forward. If you look at the last five years, BAA has been operating under a public interest finding in terms of its service quality performance and yet at the end of those five years we are still in deep discussions about why the service quality is so poor and why the international investigations, which compared BAA with other airports, put Heathrow and Gatwick right at the bottom of the list. There are clearly not enough teeth in the regulatory procedure at the moment.

Q172 Mrs Ellman: Do the other witnesses have a view on those proposals?

Mr Nicol: We have some very substantial problems with both the regulation and the manner in which the regulation is applied. We do not believe that now it is appropriate to have the regulated asset base for the scope of BAA. Effectively, we believe at least we have a one-way flow of money in our organisations from the airlines effectively to the airports. easyJet makes, say, a good margin in our industry but it is still low double figures. BAA makes a profit margin which would make King Tutankhamun blush it is so big! We have significant concerns that effectively the 7.75% which BAA has been allowed to earn on anything which it spends in this quinquennial review, the five years, means that it is allowed to spend and spend and spend and we are the ones who have to pick up the bill. We believe the regulated asset base is wrong and we also believe that the CAA could be doing more in order to control BAA's excesses in this area.

Q173 Mrs Ellman: So what do you see as the alternatives for the regulatory asset base?

Mr Nicol: I think there will be a role for regulation, a regulated asset base, a return on assets for, say, vital infrastructure, monopoly infrastructure such as runways, for example, but if you look at Stansted there is no reason why, for example, a new terminal (which I am sure there will be in Stansted in due course) would have to be operated by BAA. This is coming to one of the things which Dr Ellis was saying. You might begin to get a bit of competition between terminals within a particular airport, rather than simply giving more terminal capacity to BAA to spend.

Q174 Chairman: Do not all businesses meet their costs from the revenue from customers?

Mr Nicol: Yes, absolutely. It is a question of whether they are a monopoly or not and in our minds one of the problems which we have had at Stansted, and the reason why the constructive engagement failed, was because the amount which BAA wanted to spend at Stansted, despite coming down from a very high number, was still a very high number and we felt that was too much. The level of gold plating which we felt was going on at Stansted was just too high. It is a relatively small thing, but to give a cast iron example, the suitability of the infrastructure to take

the A380. No Stansted operator operates anything like an A380. No airline that I can think of is going to put an A380 into Stansted in the coming decades, so why are we the users, particularly easyJet and Ryanair, going to be expected to pay for that? So all customers, all airlines, all businesses operate where their customers pay for them. It is just a question of how monopolies are regulated.

Q175 Chairman: Do you ever consider shifting? If this is such a wholly inadequate organisation with whom you deal and if they are producing plans which are way beyond anything that you can perceive is in your commercial interests, have you ever considered shifting airports?

Mr Nicol: We have shifted some capacity out of Stansted over the course of the last couple of years and going back to probably 2005. It is not significant, but we have probably reduced our capacity there by about three or four aircraft, so probably 20% of our capacity at Stansted has moved.

Q176 Chairman: Do you intend to continue that?

Mr Nicol: We are okay with things as they are now, but that is because the increase to 35 million passengers, you will have noticed, obviously, has been rejected so we are not too sure where that is going to go. Also, in terms of the next generation, the big Stansted rebuild, we are still waiting to see the numbers on that and only then would we be in a position to make a decision.

Q177 Chairman: Dr Ellis, are you thinking of moving?

Dr Ellis: Certainly not, Chairman. I think the problem in the south-east of England is that there is a great shortage of capacity and it is inconceivable that British Airways would be able to move its hub operation anywhere else in the south-east of England. We actually have about a billion pounds worth of our own investment tied up in the airport as well. There is no capacity to go anywhere else.

Q178 Chairman: Mr Langford, you can go anywhere!

Mr Langford: I have to say Heathrow is so bad we have shifted some capacity to Stansted, so we do have the ability. Heathrow is still the premier international airport, but we have begun services to Stansted.

Q179 Chairman: If you are right about your passengers not particularly liking Heathrow, you could actually shift some of your flights to Frankfurt, or Schiphol?

Mr Langford: We could do so.

Q180 Chairman: Have you done so in the last year?

Mr Langford: Our international growth has been in other points in Europe and Asia.

Q181 Chairman: But that is in addition to those services which you already provide. Have you shifted anything from those airports which you consider to be inferior airports?

Mr Langford: No, we have not.

Q182 Mrs Ellman: Mr Langford, American Airlines has recommended separating, whether by divestiture or some other means, the economic interests controlling Heathrow, Gatwick and Stansted. What does that mean?

Mr Langford: Actually, the Chairman of my company said it. He said, "The only thing worse than a public monopoly is a private monopoly!" I believe we need more competition. I believe that we need more competition between airports. I think we need to find a way to find means, whether through regulatory means or through divestiture, for each airport to operate much more efficiently than it does now.

Q183 Mrs Ellman: Mr Nicol, you do not think breaking BAA up is the answer?

Mr Nicol: The break-up of BAA is one of these big Titanic issues in our industry. It is a good easy way to get headlines, to call for the break-up of BAA. Our view, though—and it is to amend the view from American Airlines—is that what would be worse than a single monopoly controlling Heathrow, Gatwick and Stansted would be three individual monopolies. Gatwick will still be a monopoly, Heathrow will still be a monopoly –

Q184 Chairman: I do not think you can have three individual monopolies, that is the minor problem.

Mr Nicol: This would be the discussion on how would any potential break-up work. You hear people advocating that all three airports should be sold off, yet they all control, they all have a monopoly of, their local markets. Stansted, Gatwick and Heathrow do, and in effect what you would do is simply create mini-monopolies rather than a big monopoly. That is our point that regulation needs to be better. It is not about ownership.

Q185 Mr Scott: I have a brief question for all of the witnesses. Security is paramount. The most important thing for any passenger is now their security in travelling on airlines. You have said that there are problems with queues, et cetera, at all of the airports. Can you tell me of any experiences elsewhere in the world where they have got a much more successful way of dealing with this?

Mr Nicol: What we noticed after 10 August last year was that most airports very quickly—this is within the European sphere within which easyJet operates—got back to business. Luton Airport, which is sort of broadly comparable in size to Stansted, was back operating at a similar level to previously very quickly. What we noticed was that it was only the BAA airports which we operate from, Gatwick and Stansted (Stansted in particular) where there appeared to be problems.

Mr Langford: I have to say Manchester Airport responded, again, much more quickly and much more fully, and they were able to get back to business much more easily and there is a great deal more collaboration and information-sharing in Manchester, we found, than we had in the BAA airports.

Q186 Graham Stringer: I am pleased to hear that. I would like to clarify BA's position. Four or five years ago, in giving evidence to this Committee I am right in thinking BA were against breaking up BAA, then you were in favour of it, and now you do not know. Is that your position?

Dr Ellis: We are not sure, yes. We want to see how things play out in terms of the Competition Commission's investigation and the behaviour of BAA over the coming year. A lot of things have changed in the most recent year and if things change then you have to look at them in the new context. You have got a new owner, who does seem to be exhibiting an increased commitment to Heathrow. We have a market inquiry in place, at which we are expecting to explore the alternatives to the full break-up and I have given an indication of our interest in looking at a licensing regime, setting some tougher conditions on BAA, if the right things can be put in place. I should add one final thing, which is making sure the money cannot leak out of the business. We saw in the current quinquennial review three-quarters of a billion pounds which was actually distributed to shareholders which could otherwise have been invested in the business. This time around I suppose the danger could be that the money goes into paying off the debts, and we are looking for some form of ring-fencing of the financial structure. So if those issues can be addressed, we are open to finding an alternative to full-scale break-up. The world has changed.

Q187 Graham Stringer: What commercial decisions have you had with BAA about these issues? I am not talking about the constructive engagement, which is primarily about pricing, is it not? It is very surprising that a major company like BAA has three positions in five years on something which is fundamental to your operations. Have you had commercial discussions with BAA?

Dr Ellis: Not in relation to these matters. There are discussions going on, certainly in relation to what provision should be made in the regulatory settlement—and this is a proposal put forward by the CAA—for ensuring that the development of another runway at Heathrow can proceed during Q5, so that is another useful straw in the wind. We have to react as the circumstances change and if that means that we have changed our position, then that is the case.

Q188 Graham Stringer: Have you had discussions with the Department for Transport about your views on BAA?

Dr Ellis: Not recently.

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Q189 Graham Stringer: When?

Dr Ellis: Personally, not for over a year.

Q190 Graham Stringer: Not you personally, your company.

Dr Ellis: I am not aware of those discussions having taken place recently. If there have been some, I can certainly find out and let you know.

Q191 Graham Stringer: I would be interested in that, because whenever I do interviews on the radio some expert comes in and says, "Well, whatever you say about the break-up of BAA, it will all be done behind closed doors between BAA, BA and the Department for Transport." So are you saying that those discussions do not take place?

Dr Ellis: I am not aware of any discussions of that nature taking place, and I think you overestimate the sort of –

Q192 Graham Stringer: I am just reporting what is said to me by the professional press and aviation firms.

Dr Ellis: Absolutely, and one sees that line adopted on a number of occasions. I am not aware of those discussions.

Q193 Graham Stringer: Again over the last five or six years you have moved virtually all your regional operations into Heathrow and many of your Gatwick operations into Heathrow. If it is so bad, why did you consolidate them there?

Dr Ellis: It is the best we have got in terms of being a competitive hub. Our competition is principally coming from Paris, Amsterdam, Frankfurt, and increasingly from the hubs in the Middle East and the Far East. Heathrow is bad, but it is far and away the best opportunity we have got to be able to compete as a global hub and we are working extremely hard to make it better. Terminal 5 opens next March and it will be a big step forward. We hope it is the first step towards a full-scale revival of the fortunes of Heathrow and the Government's consultation document last week certainly again improves that perspective. So we certainly want to work to make Heathrow a much better airport in the future for our passengers.

Q194 Graham Stringer: This is a point which was made previously: if Heathrow is so much better than Gatwick that you have moved a considerable amount of operations out of Gatwick, how can we as a committee be convinced that there would be real competition between Gatwick and Heathrow if BAA is split up?

Dr Ellis: If we could just go back to the premise, what we did was we tried to operate a split hub operation between Heathrow and Gatwick. No other airline had tried that in the world. We failed. We had to then re-balance our services and what has happened since then is that Gatwick dropped down to a lower level, but that has since been maintained and we are not cutting back on our Gatwick operations as things stand at the moment. In terms of the competition aspect, I think there is a number

of themes to this. Certainly in terms of hub competition that takes place between Heathrow and its Continental rivals and the other airports which I have mentioned. In terms of points to points services and the passengers using those, of course there is very significant competition between Gatwick and Heathrow, and indeed Stansted comes into that equation as well.

Graham Stringer: Just one last question to BA and then I will put one question to all the airlines, if I may?

Chairman: Very briefly.

Q195 Graham Stringer: Very briefly, how much business do you believe you have lost to the other major European hubs over the last three or four years because of the problems at Heathrow, both capacity and bad service, and what have Charles de Gaulle, Schiphol, Frankfurt, Copenhagen taken off you?

Dr Ellis: It has taken a considerable amount. If you look at the growth in the number of flights, for example, and the growth in the numbers of passengers going through those airports—and I will give you the details—Heathrow has been basically flat for the last three or four years and those other airports have been growing in line with the market, and in the case of Paris above the market, so Paris has been getting on for 5% and the others in the three to 4% range. That is actually quite a short historical perspective. If you go back ten years or more, Heathrow was far and away the best hub in Europe and that was good for the UK, and certainly good for us, of course, as an airline for the passengers. We are now fifth in terms of destination from the hubs in Europe and we are about, I think, to drop to sixth when Madrid goes past us after opening two new runways. So we are sliding down fast. What we need to do is to turn that around. I am sorry to return to it, but the consultation on another runway at Heathrow is actually starting to give us the opportunity to reverse that decline.

Q196 Graham Stringer: A final point to all the airlines: is not what lies behind your view of either tougher regulation or breaking up BAA that basically you are paying too much, that you are the only customers of the airports and actually the passengers and other people who go to the airport are not customers and do not have their own relationship with the airport, therefore you should control the prices? Do you think that is fair?

Mr Nicol: We certainly would not argue we should control the prices. We believe absolutely we are the customers of the airlines and our customers are ours, and we need to do everything we can to make the airport experience as good as we can.

Q197 Graham Stringer: Do you not think that passengers who buy tickets with your airline, or American Airlines or BA, are making a double choice? They are choosing the airline for price and whatever other reason, and they are also choosing

the airport in many cases because they prefer Manchester to Birmingham, or Gatwick to Heathrow, or whatever?

Mr Nicol: From our experience, people choose an airline based upon the brand and the price and they would choose an airport based on its location to where they start or finish their journey and the schedule operated from that airport. We operate to a number of destinations on the Continent from all three London airports and so people would simply pick and choose which is the right airport, from Luton, Stansted or Gatwick, from which to fly.

Q198 Graham Stringer: But that really concedes the point that the passenger is both the customer of the airport and the airline, in whatever proportions?

Mr Nicol: Yes, but they are not travelling, clearly, with the airport, they have chosen to travel with the airline. It is up to us to get the best possible deal for our passengers, particularly by working the airport.

Mr Langford: I think we have found customers are very price-sensitive. Customers like non-stop service. The value of any hub or any airport grows exponentially by the number of destinations it has, so I think the size of an airport and the number of options we provide to the customer is very important. I think many people fly out of Heathrow, despite their dislike for the airport, because of the value that it provides for the size of the hub or the geographic value to where somebody lives.

Dr Ellis: The passengers cannot negotiate directly with the airport owner. I think we have to represent their interests.

Q199 Graham Stringer: They can choose, though, to go with an airline from Birmingham or Liverpool rather than Manchester, can they not?

Dr Ellis: They certainly can. I have no problem with that point. What I would like to say is that the passenger in a sense cannot influence the nature of the product directly with the airport. They certainly report to us what they consider to be wrong. They do not like the fact that they have long queues at security, they do not like poor punctuality, that is right up at the top of their list. They do not like having to get buses out to the aircraft. Also, they are sensitive to price, so the extent to which we can negotiate on their behalf for good service, quality and to minimise the price that is paid is what the customer is after.

Mr Langford: I think the point is if the customer's aircraft leaves half an hour late because of the control post problem, they blame the airline. The airline bears the cost of late customers and their onward destinations, so obviously we are the ones who have to deal with that relationship with the airport to provide the service that the customer is contracting from us.

Q200 Mr Leech: Mr Langford, you had pointed out that Manchester had dealt with issues surrounding security far better than BAA. What lessons do the three of you believe could be learned from Manchester, or is Manchester just a poor comparison with the BAA airports?

Mr Langford: Strictly from my own point of view, being an operator in Manchester, we found that the reaction time was much quicker in Manchester, that there was much more engagement much more quickly, much more information was shared.

Q201 Mr Leech: What is the reason for that?

Mr Langford: Their management structure, their management point of view. They are used to operating in that manner. My manager in Manchester is very close to the operating people and the senior people at Manchester Airport, which is less true of the London airports. I spoke about security and I spoke about efficiency. The line is open at five o'clock in the morning, for example. People show up very early because they hear about the problems at Heathrow. If there are not enough lines open at 5.00 am queues start to build up. Queues then attract other queues and your whole day has a problem due to a small miscalculation at five o'clock in the morning. The people at Manchester, we found, do not make those mistakes and they are much more constant in having people available at 5.00 am, and the day runs well. At Heathrow you tend to be on the back foot.

Q202 Chairman: Gentlemen, that has been very instructive. Before you go, Mr Nicol, I will accept a written apology from you.

Mr Nicol: Of course.

Q203 Chairman: And we will not forget again, will we?

Mr Nicol: Thank you for pointing it out.

Chairman: Thank you, gentlemen.

Witnesses: Mr Stephen Nelson, Chief Executive, Sir Nigel Rudd, Non-Executive Chairman, and Mr Kyran Hanks, Director of Regulation, BAA Limited, gave evidence.

(Interruption)

Mr Hanks: Kyran Hanks, Economics and Regulation Director.

Q204 Chairman: Good afternoon, gentlemen. I apologise for making you wait. Would you be kind enough to identify yourselves?

Mr Nelson: Certainly. Stephen Nelson, Chief Executive of BAA.

Sir Nigel Rudd: Nigel Rudd, Non-Executive Chairman.

Q205 Chairman: Did any of you have anything you wanted to say beforehand?

Mr Nelson: Yes, Chairman. Good afternoon, and good afternoon to the Members of the Committee and thank you for the opportunity to say just a very few words at the start. As the Prime Minister

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recognised earlier this week, the future of air travel is one of the great strategic challenges facing this country at this time. It will not surprise you that we very much agree with this assessment. The bottom line to this debate is, we believe, very clear. Our airports in the South East are full and in the case of Heathrow have been so for over 17 years. At the same time, the international competition is ahead of the game. Paris will achieve in two years the capacity that we are aiming for through expansion of Heathrow through the third runway in 12 years, and we are already losing out on business and reputation as a result. On top of that, we must face the challenge of security. The abnormal has now become normal. So we confront effectively two fundamental issues. The first: how can we improve our service in the short-term? I think we are making progress, but we have a long way to go. The second: how can we create the right frameworks to deliver long-term improvements, improvements which will give the nation the airports it has a right to expect both in terms of service and facilities, but improvements which must also be delivered alongside our responsibilities to the environment and the wider community? BAA believes we can meet these challenges, but we also recognise that to do so we have to work with the rest of the aviation industry, the Government and the wider political world and that we need a collective answer to some profound questions on how we support big infrastructure projects in this country. That is why Sir Nigel, Mr Hanks and I welcome this opportunity, Chairman, to answer your questions today.

Q206 Chairman: Yes, Mr Nelson. You will realise that there is a number of very important questions we have to ask you, not only about the change of ownership but about the way you operate, the way your facilities provide a service, and you will have heard some of the criticisms of the way you treat your customers. How do you respond to the complaint that you provide a poor service?

Mr Nelson: Let me make my opening remark, that I am acutely sensitive to and regret the degree of frustration that poor service, be it queues at security, check-in or immigration, inflicts on passengers. From a personal perspective, I have been in those queues, from a professional capacity and as well with my family.

Q207 Chairman: Yes, but is it right, Mr Nelson? Do you provide a poor service?

Mr Nelson: I think that we have much to do in terms of improving our service and that we are making improvements, Chairman.

Q208 Chairman: That is a "Yes," is it? In what way is your service a poor service? We have heard that there are problems because you do not have enough people on security. We have been told there are difficulties because you do not respond with sufficient speed to the problems which arise in the airport. Is this true?

Mr Nelson: Security queues at peak times are too long. There are also occasions when lanes are unmanned and we also recognise that the general fabric of our airports has become run-down.

Q209 Chairman: Do you not have enough trained staff?

Mr Nelson: I think what is very important to say is that 10 August last year revealed that prior to 10 August, the security crisis, we had insufficient staff for a steady state operation and we also had under-investment in the basic facilities of our airport terminals. We have gripped both of those problems over the last twelve months. We have now 50% more staff at Heathrow and at Gatwick in the front line. We have 30% more spent² on basic maintenance and cleaning and we will have opened by April over 50% more lanes in Heathrow and 60% in Gatwick. It also needs to be recognised that those are what could be described as "input statistics". What is the passenger getting as a result of this? Well, as I say, we are making progress: 95% of the time at ten minutes or under over the last three months, 3% of security searches at Heathrow, passengers have experienced satisfactory service. It is the times outside of that –

Q210 Chairman: Who says that, Mr Nelson, them or you?

Mr Nelson: Our surveys indicate that on average more people find the experience at Heathrow excellent than they do very poor.

Q211 Chairman: How often do you do your surveys, given that we are talking only about a three month window?

Mr Nelson: We very regularly survey. We do 60,000 surveys a year and we are measured monthly on what we call a quality of service monitor, which ultimately will be feeding into penalties, and indeed probably bonuses.

Q212 Clive Efford: How do you respond to the charge that you have not listened to the industry in terms of the facilities you provide at airports and that where you have agreed changes or improvements at airports with the airlines those changes have not been implemented?

Mr Nelson: I think the opening of Terminal 5 on 27 March on time will represent the capability of this business both in its ambition to deliver construction of the highest world-class quality, and I also recognise that we have a difficult job meeting, for example in Heathrow, the competing demands for infrastructure of 94 airlines, but I am pleased to say that going forward for the next five years we have largely come to an agreement on a transformation plan for Heathrow which amounts to some 3.6 billion across those airlines. So my sense is that actually we are meeting the demands as put to us by airlines.

² Note by witness: Delete "30% more spent" Insert "spent £30m more this year"

Q213 Clive Efford: You have just said to us, in answer to a question from the Chairman, that the fabric of the buildings, for instance, is in a poor state of repair. That does not require planning permission, that does not require any form of agreement with airlines. Is that not something just about your management of your own assets?

Mr Nelson: I agree that we are playing catch-up here. I am pleased to say that the new owners of BAA, which is the ADI consortium led by Ferrovial, have very quickly seen the issue here of under-investment and, without compensation from the Regulator, have driven the maintenance and cleaning budgets up this year by this year by 30%. It will not be enough because if you go around the terminals, as I do regularly, we still have too much yellow and black tape, we still have areas of the terminal facilities which are not yet at the standard we want, and we still have terminals which are over-pressed in terms of capacity, but what I want to signal is that there is a very firm conviction with this business and with its leadership that we have to address these issues.

Q214 Clive Efford: We have heard that you are in a monopoly position in terms of being able to make charges to airlines, albeit within a regulatory system, so in that sense your budget is guaranteed, you are not in competition with somebody who can take that income away from you. Why, then, has the fabric of these buildings fallen into disrepair? Why have you not in the past been maintaining your assets?

Mr Nelson: I think there is a big picture and a small picture. The big picture is that we have airports which are, on any international comparison, cheap and we will have provided, and we can certainly provide, the statistics which indicate that Heathrow is cheap relative to it being the busiest international airport, and Gatwick is even cheaper.

Q215 Chairman: That is not a new situation, is it, Mr Nelson? To be fair, as long as we have been inquiring into airports the reason why there has always been the difficulties in Heathrow is that it has been a darn sight cheaper than anybody else. It is not exactly new, is it?

Mr Nelson: No. I think, Chairman, therefore we are looking at the consequences of a long-term situation.

Q216 Chairman: Oh, I see. So it has been like that for the last, what, 15 years and now we are looking at the consequences! Well, that shows responsiveness.

Mr Nelson: I think it is important to recognise that pricing at Heathrow to the airlines has remained in constant terms almost flat. It has gone up over 20 years by £1.50 and at Gatwick it has gone flat to down.

Q217 Chairman: Who decided that, Mr Nelson?

Mr Nelson: This is the regulatory framework within which we work.

Q218 Chairman: Have you objected to that in the past and said that this enabled you not to meet your targets?

Mr Nelson: I think we have had serious challenges as part of the regulatory cycle every time it comes around, every five years, but what we are now calling for is a wholesale review of this and I am glad to say the Secretary of State is looking very carefully at this for the forthcoming period.

Q219 Clive Efford: How do you respond to the claim by British Airways that your systems basis approach to airport management stifles competition? BA has said that the joint ownership of BAA of the three largest airports in the South East has resulted in severe restrictions of competition at the level of provision of airport services.

Mr Nelson: I will ask Mr Hanks to answer that.

Q220 Chairman: Mr Hanks, are you a systems-based person?

Mr Hanks: We are not any more.

Q221 Chairman: Since when?

Mr Hanks: Since 2003 the system has not existed in terms of that particular style of regulation framework.

Q222 Chairman: I think there may be a suspicion from your customers that no system exists!

Mr Hanks: To follow on from that point, we do not cross-subsidise Stansted from Heathrow any more. Again, that finished in 2003. So both those points put by British Airways and American Airlines are wrong.

Q223 Clive Efford: Why would that be then? Why would BA be working on this misunderstanding as to how you are operating? Does that not indicate there is a slight breakdown in communication?

Mr Hanks: I think what they are referring to there is the structure of BAA rather than the nature of the regulatory framework, and clearly we do operate as one company across the South East.

Q224 Clive Efford: May I suggest then that you have got no incentive to promote intra-group competition? What would you say to that?

Mr Hanks: When the airports have no capacity there is no scope for competition. It does not matter who owns these airports, they cannot compete when there is no capacity.

Q225 Clive Efford: What about the charge that you have been insulated by the airlines from some of the worst effects of the poor quality of service?

Mr Hanks: The regulation review we have just gone through does not feel like we have been insulated from the worst effects of poor quality of service. We have had a very tough regulatory settlement, in part based on the quality of service which is being delivered in the current regulatory period.

Q226 Chairman: It was tough in what sense? They said you should give your customers a good service? Is that what they said?

Mr Hanks: No, they have doubled our exposure to poor quality in the next five years.

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Q227 Chairman: Because they did not think you were doing very well, to use an English understatement.

Mr Hanks: And they have decided to incentivise us to deliver a better service in the next five years.

Q228 Chairman: So even though you have not got the capacity, you are going to be incentivised?

Mr Hanks: That is the nature of the regulatory framework, that you have carrots and sticks.

Q229 Clive Efford: But do the airlines have a point about the poor quality of service? The way you have been able to respond to the increased demand for security measures over the last year and a bit—do you think your response has been adequate? Do you think it has met the needs of the passengers or the airlines?

Mr Nelson: I think, quite clearly, given the amount of passenger dissatisfaction we have to accept that for many passengers it has not been satisfactory. When you are in a queue it is not satisfactory, but what we have done is we have accelerated as fast as we can the recruitment process. You cannot simply just drag people off the street and put them in a security operation. It is very clear that it is a highly trained operation. We have taken over 35,000 applications to get the numbers that we have. It has taken up to 20 weeks with reference checking, criminal records checks and also the ability to test whether people can actually read the X-ray machines. So am I satisfied with the pace at which we have recruited? No, but needs must to work against quite a difficult recruitment process.

Q230 Clive Efford: Do you think that BAA as it is currently structured has responded well to competition from other airport hubs in Europe and other parts of the world?

Mr Nelson: The first point is that I welcome the fact that you recognise that we are in competition with competing hubs. We are losing traffic, and we are losing traffic because the transfer experience through Heathrow, partly as a result of the security regulations and partly as a result of our capacity constraints, is not satisfactory.

Q231 Clive Efford: Is this just a workman just blaming bad tools? We have heard from BAA that traffic has been lost. Do you think your response to that has been adequate, or do you think that BAA in any way is responsible for any of that loss of traffic?

Mr Nelson: What I will say is that we have got every incentive, because we are a commercial organisation as well and when we do not hit our passenger forecasts there are commercial impacts for us. We have got every incentive to recruit as fast as possible and to secure better standards of service so that we do not have people saying, “There’s too much hassle at Heathrow. We will go elsewhere, through Paris or through Amsterdam.”

Chairman: So as you have got that incentive you do not need any extra, is that right?

Q232 Mr Martlew: Just on that point, you said you had 35,000 applicants. How many people have you taken on?

Mr Nelson: Close to 2,000 as a result of that, so we are operating at a 5–6% success rate.

Q233 Mr Martlew: What is that 2,000 as a percentage of your total security force?

Mr Nelson: It is about 50%.

Q234 Mr Martlew: So you have increased it?

Mr Nelson: We have increased it by 50%, and we will go on recruiting until we get better standards of queuing. Could I just make the point that, for example, coming up to December, where of course we are looking very carefully at the Christmas period, there are times both in Terminal 2 and Terminal 3 where we will have all lanes fully manned and there will be queues because of the physical capacity constraints.

Q235 Mr Leech: Just on this point, I do not know whether you were here during the previous evidence but American Airlines suggested that it was not just about bodies, it was about management responsiveness. Do you have any comments in relation to that, because certainly Manchester does it a lot better than Heathrow and Gatwick? Why is that?

Mr Nelson: Mr Leech, I will not comment on Manchester’s performance. What I think we can do is constantly improve in this area. I am confident that we have management teams who are absolutely clear, working with lots of dedicated people, to improve the standards of our service and build back our reputation.

Q236 Chairman: Yes, but is it true, Mr Nelson? Nobody doubts your goodwill, but you are being asked a different question. Is it true? They say you do not respond. They say, “We’re talking to you. It’s not as good as it was two years ago.” Is it true?

Mr Nelson: As I say, I do not want to make comparisons with Manchester –

Q237 Chairman: We are not talking about Manchester. They are telling us about you. Are you less responsive than your teams were two years ago, and if so, why?

Mr Nelson: No. I can very confidently say that that would not be the case. It is the capacity constraints, the lack of recruitment—as I said, we were playing catch-up—and the very severe security regulations that have put us under pressure. Another way of putting it is the investment in our business has not matched the growth in passengers. We need to turn that back and we need to reinvest in this business. That is what we are doing.

Q238 Chairman: How fast are you doing that? Surely the business of communicating with your customers should not come as a sort of surprise to you, should it?

Mr Nelson: No. I think there is a very great sense of urgency in this business, as you might well imagine given the amount of public criticism we have been under. There is very sustained and great sense of urgency to recruit, to improve our processes and to make sure that management are absolutely focused on what we call putting the passenger first.

Mr Wilshire: Chairman, if you will allow me, before I come to my question, to say, given the local protest we witnessed earlier on, that the overwhelming majority of the neighbours of Heathrow whom I represent would totally disassociate themselves with the views of the self-appointed and self-opinionated!

Chairman: Mr Wilshire, with respect, this is a Parliament which responds to anyone who wishes to approach us. If people are so unsure of their arguments that they need to disrupt the sitting of a Select Committee, that tells us very clearly of the standard of those people, and I do not think we wish to discuss it any further. Did you have any questions for the witnesses?

Q239 Mr Wilshire: I think I have made my point. Yes, I do have some questions, but I think it is important to get the record straight. Could I just start with the situation of Terminal 5 coming on-line. Is there not a tendency for all the shortcomings, irrespective of who is responsible for them, to say, "It will all be alright on the night when Terminal 5 opens"? Is there not a danger of raising expectations that that might be a solution for more things than it will be?

Mr Nelson: I think the right way to consider Terminal 5 is step one. We are as clear as anybody that Heathrow needs to be transformed. Terminal 5 at a stroke will reduce the numbers of passengers going through Terminal 1 by about 50%, the numbers of passengers going through Terminal 4 by about 75%, and that will level out to 50, and the numbers of passengers going from Terminal 2 by about 15%. That will provide from April very considerable relief to passengers in physical terms. It needs also to be understood that Terminal 3 will actually get busier; it will go up in passenger terms by about 10%, which I think plays to the point that it is not just Terminal 5, it is the development of the whole campus in physical terms, and that is what our plans are in front of the Regulator. It is the development of the whole campus that needs to be delivered.

Q240 Mr Wilshire: Rather a lot of people are aware of the problems at Heathrow. Which of those problems do you consider are your responsibility and which are the problems you consider are the responsibilities of somebody else?

Mr Nelson: Before I go into this, it is important to say that I see no upside from the blame game and I personally have steered well clear of the media. However, it does need to be articulated that BAA controls, let us call it two of the six major factors in customer satisfaction. We control central security and we control the retail and the catering. We do not control check-in. We provide the desk, but we do not control the manning of the check-in.

Q241 Chairman: However, Mr Nelson, most of the evidence we have got has been about exactly those bits which you control.

Mr Nelson: With respect, Chairman, there is enough evidence also to suggest, both anecdotally and on websites, that check-in queues have been considerable as well.

Q242 Chairman: So we are not in the blame game, we are just saying the others are as bad as us?

Mr Nelson: I accept that point, but immigration is Home Office and baggage reclaim—the time it takes for the bag to be transported from the plane onto the reclaim belt is under the control of the airlines handling agents. We are responsible for the kit. Finally, punctuality, which with an airport as full as Heathrow can be anything from weather-related to schedule-related issues.

Q243 Mr Wilshire: Can I turn to the impact of the takeover which occurred recently? Can you give us any indication of what the impact of that takeover has had on three things, on management, on the levels of maintenance you are able to carry out and the issues of investment or under-investment, or the possibility (if I understand the Press correctly) of not being able to make some of the investments?

Mr Nelson: I will make my comments and then I will ask Sir Nigel to make any comments he wishes. I welcome the opportunity just to restate very quickly that Ferrovial and the other two shareholders said, "We must invest, irrespective of any regulatory compensation, in cleaning, extra security guards and maintenance and in making sure that travelers, lifts and escalators work better." That has been, to date, a £30 million investment which, in commercial terms, comes off the bottom line. That for me is the sign of investors prepared to grapple with these issues rather than to pull money out.

Sir Nigel Rudd: Chairman, I would just like to add that the dealings I have had with Ferrovial—and, as you know, Chairman, I have only been Chairman of the company for two months, but all the dealings I have had with Ferrovial and their partners demonstrate their willingness to get this right, to invest in this airport to make it a world-class airport.

Q244 Chairman: Yes, except, Sir Nigel, you will realise that if anybody takes on any deal with carries with it such an enormous amount of debt inevitably people are going to wonder where the priorities of the company are going to lie. Are they going to lie with the interests of the airports, with the British interest in having a first-class hub, or are they going to lie where they ought to in legal terms, in the narrow sense, with their shareholders in returning the best possible return on their shares? They are not unreasonable questions.

Sir Nigel Rudd: Certainly, Chairman, they are not. The assurance I had when I took over the chairmanship of this company is that there will be adequate financial facilities available to make the investment which is absolutely required in this airport to make it a world-class airport.

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Q245 Chairman: Was it explained to you how the burden of debt would affect that investment?

Sir Nigel Rudd: The raising of debt will not be an issue. The issue is the price and the return that will be obtained from that investment, and you have to realise that BAA has been a gross user of cash for the last five years and as far as I can see for the next five years. The difference between EBITDA, that is profit plus depreciation, against the capital expenditure in the last five years has been £2.8³ billion. In our plans going forward there is going to be another £4.5 billion put into the airports to develop Heathrow East and refurbish Terminal 4 and do some work on Terminal 3. So the net cash going out to shareholders is negligible. What they have to do is to borrow money and to make a reasonable return on their equity investment over the long-term.

Q246 Mr Wilshire: Very briefly, is Mr Nelson aware of the Populus survey which indicates that the majority of people living near the airport support its development rather than oppose it?

Mr Nelson: Yes, I am, Mr Wilshire.

Q247 Mrs Ellman: Mr Nelson, you seem to try to gloss over a lot of the problems. After all, there has been a lot of very bad publicity for BAA and for Heathrow in particular, has there not? Do you not think you are trying to gloss over this?

Mr Nelson: It is certainly not my intention, Mrs Ellman, to gloss over anything. What I am very keen to convey is that regrettably the fixes are not quick, but this is a company gripping the problems transparently and making progress. We are not sitting on our hands. We want to improve service against these high pressures which we face.

Q248 Mrs Ellman: What about the problem of queuing? You do not seem to see that as very important.

Mr Nelson: I am sorry if I have conveyed that queuing is not important. It is extremely important. It is probably our number one priority operationally, as I say, security queues, the ones we control. We have brought down the queues. It is no satisfaction to somebody who is standing in the queue for me to say that 95% of the time at Heathrow it is ten minutes or under, because if you are in the 5% you are in a long queue. But we have made significant progress and we will continue to make progress.

Q249 Mrs Ellman: You referred to some areas, including queuing, which you say are not your responsibility, but as people who run and own the airport what do you do about ensuring that those with the specific responsibility view it differently?

Mr Nelson: It is a very important point. We must seek—and I think we are putting a lot of effort into this—what we are calling a consensus and leadership from the top, from the CEOs of the airlines, from myself, from Government, to look to the passengers'

interests in the round. I make no apologies for taking this back to regulation, the big picture. Until we get a framework which does not pit the airlines against the airport operator but actually looks as collaboration and cooperation in a better way than we have currently got, then we will not get the best experience for the passenger. In the meantime, we will continue to work with the airlines to improve things.

Q250 Mrs Ellman: American Airlines gave us evidence this afternoon about problems experienced by their staff getting through controls at the airports. Is that a problem you are already aware of?

Mr Nelson: I am aware that on occasion we do have queues going through the staff checkpoint. It is not just airlines, it will be our own staff as well and any other people working air-side. Again, that is not a problem we want to take lightly and we must make sure that is improved.

Q251 Mrs Ellman: What are you actually doing to get improvement secured?

Mr Nelson: For most of the actual staff searches there is only a limited physical capacity, which will be one or two security lanes. So we have maximised the security lanes where possible to ensure that we can get people as quickly as possible through. But if there is, for example, a queue on the motorway and if there are –

Q252 Chairman: Mr Nelson, we were told that crew have been held up as long as an hour. If you hold up an aircraft crew, the aircraft cannot take off on time, it loses its slots and it is in considerable difficulty. Is that true, and are you aware of it? If you are aware of it, how often does it happen?

Mr Nelson: I will check the statistics and get back to you.

Q253 Chairman: Mr Nelson, surely in the talks you have had with the airlines they cannot have been silent on this matter. Are you aware of any of the crews having difficulty getting through security and being delayed with an effect upon their flight time?

Mr Nelson: Chairman, I was certainly aware of the intensity of the problem in and around 10 August and beyond. I have not been made aware of this recently and the issues we tend to talk about in regular strategic dialogue with airlines is around control posts and less around the staff security.

Mr Hanks: If I could add, as part of the next regulatory settlement there has been an agreement made with the airlines at both Heathrow and Gatwick to put a service quality incentive on the airports to minimise the queues at those control posts.

Q254 Chairman: So you admit in fact this is happening, you have accepted it and you believe that now you have got to do better?

Mr Hanks: And it will be resolved in the next regulatory period.

³ Note by witness: Delete "2.8" Insert "2.2"

Mr Nelson: At the control posts.

Q255 Mrs Ellman: Will an increase in airport capacity give you an even greater monopoly position or have you got any ideas of introducing competition?

Mr Nelson: I will ask Mr Hanks to take that question.

Mr Hanks: There will not be an increase in airport capacity in the South East until 2015 at the earliest, when we have plans to deliver the second runway at Stansted, and then probably 2020 when there are plans to deliver capacity at Heathrow. The demands for that capacity mean that it will be taken up almost instantly, so it will not increase the position, the market share if you like, of BAA.

Q256 Mr Martlew: The emphasis on stricter border controls and passport controls—as I say, I went through Stansted at the weekend—is that causing problems? Are there delays at the border controls?

Mr Nelson: There are delays at border controls, and again it serves no one, I think, to be casting blame. What we are doing is—and this is welcomed by both the DfT and the Home Office—we are putting automated systems in so that we can measure exactly what those delays are and we will have those implemented in the spring.

Q257 Mr Martlew: Would it not be better just to put more passport operators there?

Mr Nelson: That is a matter for the Home Office and I think it needs to lie with the Home Office in that context.

Graham Stringer: Mr Nelson, I have lost count, you might be the fifth or the sixth senior representative of BAA who have sat at that table before the Select Committee over the last ten years. You are the first one to be in favour of a third runway, rather surprisingly.

Chairman: Openly!

Q258 Graham Stringer: The first one to tell this Committee that you were in favour of a third runway. Why is that?

Mr Nelson: We have been, for the last two or three years, publicly supportive of the White Paper. We think the White Paper, which was issued in 2003 after extensive consultation, is a well-judged document and it is well-judged for the following reason: it says that demand will exceed supply even if you build two runways, first at Stansted and then, providing the limits can be met, at Heathrow. Therefore, we supported it. Second, we are a commercial organisation and growth serves our commercial interests, but I see no conflict between the support for the White Paper and now our public support behind the Government for this policy.

Q259 Graham Stringer: That is rather missing the point, is it not? You are in competition with major hubs in Europe which have four and five runways. Possibly in the next ten years we will get a third runway. You are going to be at a competitive disadvantage. That has been known for the last 15

years, and yet it is only in the last 18 months, two years, that BAA has said it is in favour of a third runway. What has been going on? Why is a commercial organisation not been in favour of this extra piece of vital infrastructure?

Mr Nelson: I think it is very important to go back and to see the process which has had to take place here to get to the consultation which took place earlier. The process has been effectively a policy statement, to which we and others were contributors, and then –

Q260 Graham Stringer: Just let me interrupt you, because I think we are going down the same path. Are you saying that BAA did not understand the need for a third, possibly a fourth runway ten years ago?

Mr Nelson: I think, Mr Stringer, the situation 12 years ago when we publicly said that we were not in favour of a third runway is a very different situation from the one now, with 55 million passengers travelling through Heathrow, and we now have 67/68 million.

Q261 Graham Stringer: The actual current passenger numbers are below the projections you were giving 12 years ago, so you cannot use the fact that now we have more passengers because you were publicly projecting (as was the Government) a great growth in air travel. What I want to know is why a major commercial organisation has not come forward and wanted something that was vital to its business. Had you had, as I said in the previous interview, private conversations with the Department for Transport which told you not to go ahead?

Mr Nelson: I am puzzled by your observation. We have been very firm advocates and supporters of the White Paper, which is very explicit about not only the runways but the sequence of the runways.

Q262 Graham Stringer: It is, but all the way through the T5 inquiry witnesses from BAA who came here before that White Paper said it was not a matter for them. BAA either had no view or was opposed to a third runway. A commitment was given at the T5 inquiry that you would not have that. Why was that?

Mr Nelson: I hope you will understand that, having been in the job for 14 months, it is difficult for me to comment genuinely –

Q263 Graham Stringer: No, I do not understand. This is absolutely vital both to the country and to BAA. I do not understand that your memory only goes back 14 months. No, I will not accept that as an answer. I want to understand why this country is disadvantaged by not having enough runways and why the owners and operators of the major airport has not been pushing for that.

Mr Nelson: I think your point is a very relevant point, which is that we have had to work very hard in support of the process that led to Alistair Darling's White Paper in 2003. Up to then there had been no government policy governing a runway expansion, no runway built in the last 50 years, and to that

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degree we have become very firm supporters of the policy. Now that we are in formal and open consultation, we have gone public with our support, but I do not see a contradiction there.

Q264 Graham Stringer: Can you tell me of another commercial organisation that waits until the Government tells it what its commercial interests are?

Mr Nelson: I think this is again, if I may, an important point. The development of runway capacity, for the reasons we have been visibly presented with this afternoon and for many other obvious reasons, has to be policy-driven by government.

Q265 Graham Stringer: That is rubbish. I developed the only other runway which has been built in this country over the last 50 years and we did not go and ask Government whether or not they were in favour of it. We told them what the plans were and why that was important to Manchester Airport and Manchester. Is the point that you actually did go to Government and ask them what to do?

Mr Nelson: No, I come back to the point I am making: we have been supporters of the process leading to the White Paper policy and we have been public supporters of the White Paper policy. We recognise that it meets not only in the South East but is also purported to meet the demand constraints in other parts of the country and that right now, as far as I know, we are the only major airport company which is pushing for the development of two runways.

Q266 Graham Stringer: Let me approach this another way. Is not one of the reasons why there is so much anger in west London about this development because you gave a commitment that there would not be a third runway, and when you were considering giving that promise what considerations did you take into account?

Mr Nelson: It is simply not possible for me to speculate on the particular reasons why there is so much anger over and above the obvious fact that when you develop runways there are local impacts.

Q267 Graham Stringer: It is not a speculation if you gave a commitment that you were not going to build a third runway and then you say you are in favour of it. That is not a speculation, it is fairly straightforward; it is a big whopper!

Mr Nelson: There will be some who represent this to me, who say, "Why is it exactly that 12 years ago there was a written commitment and now BAA is supporting development?" but whether that represents the two million people in west London who will be overflown more, I cannot say.

Graham Stringer: Thank you.

Q268 Mr Hollobone: Sir Nigel, you are a very distinguished businessman, you do not take up these jobs lightly, and our inquiry is called "The Future of BAA", so presumably you undertook your own inquiry into the future of BAA before agreeing to be

Chairman two months ago. I wonder if you could share with this Committee your SWOT analysis—the strengths, weaknesses, opportunities and threats of BAA—and the process you went through before taking the job?

Sir Nigel Rudd: First of all, I passionately believe in better infrastructure for this country. I am a regular user of the East Midlands line into St Pancras and we can see how that can be transformed by investment and how it can regenerate a whole area, so I passionately believe in that development. That is one of the reasons why I took on the job. I did my research into the consortium to see whether they had adequate finance to meet the commitments, and they have. There are issues, of course, about return on capital, which we can go into. They are very, very serious issues, but they have the ability to run this business and run it well and invest. My reaction when I actually got into the business—as you probably know, I have bought and sold a lot of businesses in my time and it always struck me that when you get into a business it is never as it seems, and I was absolutely staggered to realise, because I assumed as a customer that the retailing went to BAA and of course it does not, it goes into subsidising landing fees. It is what is described as a "one till", so the car parking the retail, everything goes into one till and then the calculation made by the Regulator of the allowable landing charge is made after that. I had always assumed, as probably a lot of us had—maybe not the people who know the industry well –

Chairman: Sir Nigel, you should have read our report. We actually explain this in some detail! We will send you a copy of the previous report. You will find it helpful. Mr Hollobone, did you want to get on?

Mr Hollobone: I am very interested in Sir Nigel's philosophy –

Chairman: We are all interested in Sir Nigel's philosophy, and I am sure he would be delighted to come back and tell us about it on some other occasion. However, we need to know about mixed mode and we need to know about some of the other problems, and we will be into a division in a moment.

Q269 Mr Hollobone: I am in your hands, Chairman. I was particularly interested in Sir Nigel's assessment of the weaknesses and the threats to BAA which might threaten its future.

Sir Nigel Rudd: I see the business as two businesses, as an infrastructure building business and as a running of an airports business. The running of the airports business actually has to be improved. Stephen has explained how we are going to do that, and it is actually very important that we make the changes, and the new infrastructure will help us to do that.

Q270 Chairman: Sir Nigel, suppose BAA was asked to divest itself of one of the London airports. Is that going to create more competition?

Sir Nigel Rudd: The Competition Commission is looking at this. My perception—and, as I say, I am new to the industry—is that it will not, because I do not believe that most people make a choice of an airport by the standard of the airport. They make a choice by which airline is flying from that airport.

Q271 Chairman: Yes, but you have just actually made an interesting division and said that you see the company as having two halves, one of which is property and business and the other is running the airport. Some of us do not quite see that difficulty. For example, supposing BAA was asked to copy the system used at JFK, where terminals are owned and run by airlines. What would be your response to that?

Mr Hanks: That is a situation we are aware of in JFK. JFK is a much bigger airport.

Q272 Chairman: I am sure you are aware of it, Mr Hanks, but what would your response be if you were asked to do it?

Mr Hanks: There is not the space for that kind of competition at any of our London airports.

Q273 Chairman: But you have just been telling me that there is so much investment going in in the next ten years that you will have completely new terminals and in fact you may actually be able to offer this new high-quality, beautifully organised, very efficient terminal to people on precisely that basis.

Mr Hanks: We cannot add more space at the airports. We can improve the quality of the facilities there, but Heathrow will be the same size and it will still be four terminals, as it would be –

Q274 Chairman: The airlines are already grouped, are they not, in different terminals?

Mr Hanks: They are, and there is not the space to move them around.

Q275 Chairman: Has anyone given any attention at all to the question of mixed mode running?

Mr Nelson: Yes, Chairman. We would be supporters of mixed mode for two reasons. One, it reduces the stacking that will occur over London, and thereby has an environmental benefit, but it also gives us an operational benefit because it reduces the possibility of congestion. The second one is that it obviously is a more efficient use of the runways, so that we can actually drive up growth without having to put the third runway down before we have exhausted the capacity of mixed mode.

Q276 Chairman: So is it essential for the efficient running of the new Terminal 5?

Mr Nelson: No, it is not, Chairman. The running of the new Terminal 5 has nothing to do with more air traffic movements or more runway capacity. It is a very welcome addition of 40% more space for passengers in Heathrow.

Q277 Chairman: Sir Nigel, which do you think is most important to your shareholders, the overall transport interests of the United Kingdom or the return on the capital they have invested?

Sir Nigel Rudd: I do not think they are mutually exclusive. I think that most businesses—and I have been in the business of looking after customers and if you look after customers then you will do quite well; if you do not, you will not.

Q278 Chairman: You do not feel there is a little way to go before BAA can be put in that category?

Sir Nigel Rudd: I think there is a long way to go, but we are intent on being there.

Q279 Chairman: It is quite clear to your masters that in fact this is a major transport hub which is fundamental to the economy of the United Kingdom, and if we get it wrong it is going to cost us a very great deal in terms of jobs and investment?

Sir Nigel Rudd: I think that is absolutely crucial and that is why I took on the job.

Q280 Chairman: They have given you undertakings that you will get the support to do that job in a way which is not only supported by your individual shareholders but is of interest and support for the United Kingdom?

Sir Nigel Rudd: I have said, Chairman, the capital is available. What I really worry about is the return on that capital. All commercial organisations have choices of where they put their capital and if there is not an incentive to invest, then it makes it very, very difficult.

Q281 Chairman: Do you think that Ferrovial and the other shareholders just did not do that due diligence before they took over the company, or is this something they have discovered recently?

Sir Nigel Rudd: I think they have been genuinely surprised and shocked by the reduction from 7.75% to 6.2% in the present review. They are shocked.

Q282 Chairman: Why?

Sir Nigel Rudd: Because they believe that the risks that were envisaged five years ago in running an airport have not changed substantially, that there are market risks in the market, as we know today, with banks, et cetera, and they think it is totally unreasonable.

Q283 Chairman: And yet they were unable to make their case successfully, is that what you are telling us?

Mr Nelson: Perhaps I could just add, the reason why it was shocked was that that change, 155 basis points, is three times the average of regulated changes over the last ten years, excluding BT, so it is unprecedented.

Q284 Chairman: But equally, Mr Nelson, you have already been telling us—and if you have not, your customers have been telling us—there have been considerable changes in the way you operate over the last ten years.

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Mr Nelson: And we would imagine that actually the risks of operating and building out a runway, and indeed an airport of the kind of Heathrow, are going up rather than down, but what that settlement indicates is that the risks have gone substantially down, and we do not accept that.

Sir Nigel Rudd: Chairman, as I have said, I care passionately about investment in infrastructure and this sends a terrible message to any bidder who is thinking of investing in infrastructure in this country.

Q285 Chairman: For what reason, because the due diligence which was done before did not indicate that this was an area which might be at risk if different decisions were taken by the regulatory bodies? Is that what you are telling us? Why would one buy something which was regulated by an

authority which was at great liberty to make precisely the estimates they have made in the interests of the industry?

Sir Nigel Rudd: They did their calculations and clearly they did not expect that reduction.

Q286 Chairman: So really one can only say it is very wise, before taking over a major investment of this kind, to ensure that people giving you advice are at least basing their estimates on the possibility and probability that there will be changes?

Sir Nigel Rudd: Chairman, they had that advice and the advice was clearly wrong, because the rate which has been offered is far lower than that advice, and I have seen that advice.

Chairman: I think, Sir Nigel, you should tell them to ask for their money back from the people who were their consultants. Gentlemen, you have been extremely helpful. Thank you very much indeed.

Witnesses: Mr Jim Fitzpatrick MP, Parliamentary Under Secretary of State, and Mr Jonathan Moor, Director of Airports Strategy, Department for Transport, gave evidence.

Q287 Chairman: Minister, I think all we are going to have the time to do really is to say hello to you. I apologise if we have kept you waiting. Normally, we are very loath to keep important persons waiting. Would you be kind enough to identify yourselves for the record?

Jim Fitzpatrick: Chairman, thank you very much. I am Jim Fitzpatrick, Parliamentary Under Secretary at the Department for Transport and Aviation Minister. If I may, Chairman, introduce Mr Jonathan Moor, who is Director of Airports Strategy at the Department, who will be with me this afternoon for any evidence to the Committee, if that is okay. Can I read a very short statement, Chairman?

Q288 Chairman: We would be delighted to hear from you, Minister, but you will not be surprised if we all rise to our feet and run away in the middle of it!

Jim Fitzpatrick: Of course. I thought it might be helpful just to say a few words on where we are in respect of policy, if I may, Chairman. We set out a sustainable long-term strategy for the development of air travel out to 2030 in the Air Transport White Paper in 2003. There we made clear our support for additional capacity at some UK airports, but only where the case is strong after accounting for the environmental implications. We particularly support additional capacity at two of BAA's airports in the South East. The pace of change in the industry has raised the potential for regulatory and structural changes in the near future. We have just completed a public consultation on the designated status of Manchester and Stansted Airports, with the decision due soon. In addition, the Competition Commission is currently carrying out an inquiry into the supply of airport services by BAA, which may have implications for the structure of the industry and the Secretary of State has invited Sir Joseph Pilling to carry out a strategic review of the CAA.

These reviews may restrict our ability to respond fully to questions from the Committee, but we will do our best to answer what we can, Chairman.

Q289 Chairman: That is helpful. You do understand that we are aware of all the things that are going on around this subject, but of course we have taken quite a lot of evidence this afternoon and we have quite a lot of written evidence that we would like to question you on. Normally, I do not allow ministers to say to me, "Don't ask me that," but I am sure you will indicate to us if you think we are going too far, and we may even argue with you, who knows? Does BAA's gearing jeopardise its ability to raise the finance required to deliver the necessary additional airport capacity for the South East?

Jim Fitzpatrick: It is our view that given the CAA's recently published proposals and price caps for the next five years beginning from April 2008, the CAA has a duty to provide airport owners with the incentive to invest. Having also taken into account the Competition Commission's own recommendations on price caps, the CAA is confident that its proposals will provide adequate incentive for BAA to invest. The financing obviously is a matter for BAA. The ability to deliver the investment supported in our White Paper may be affected in the medium term by the ability to obtain finance on reasonable terms, and we were concerned about this possibility at the time of acquisition. Ferrovial provided us with assurances of their support for the investment programme, so we are quite confident that the investment we anticipate and the expansion we see is required will be deliverable.

Q290 Chairman: Because, after all, commitment is not quite the same thing as the ability to invest, is it?

Jim Fitzpatrick: No, but given the structuring package which is in place, given the outline investment the company has made, given our

discussions with them at that time and their ability, given the fluctuations in the market and everything else, given the CAA's recommendation of where the price regime should be for the next five years, we think within all of that envelope there is real confidence that Ferrovial can deliver and will deliver and we have no reason to think, notwithstanding the financial turbulence in the markets, that that will prevent that from happening.

Chairman: I think we may want to question you a bit on that.

Q291 Mrs Ellman: What exactly is the current consultation on expansion at Heathrow all about? Is it about whether there is expansion, the extent of the expansion, or when it is actually going to happen? Is it the date we are talking about?

Jim Fitzpatrick: The consultation is covering a whole range of issues. The main aspect is that in the 2003 White Paper and in the –

Chairman: I am sorry, Minister, now the Division Bell is ringing. The Committee is suspended.

The Committee suspended from 4.18 pm to 4.27 pm for a division in the House.

Q292 Graham Stringer: We were just with the previous witnesses, Minister, discussing how we had got here, how we had got to a situation where Heathrow, which is one of the world's premier airports, is now in a situation where it is at a competitive disadvantage with at least four, if not five other European hubs which have more runways. Can you shed any light on how we have allowed the country's premier airport to get into that situation?

Jim Fitzpatrick: Chairman, do you want me to finish the answer to Mrs Ellman's question about what we are actually consulting on at Heathrow?

Chairman: Of course, yes.

Q293 Graham Stringer: And you can think about that one!

Jim Fitzpatrick: Yes, well, that is probably true indeed, Mr Stringer. Chairman, what we are consulting on primarily is additional capacity for Heathrow. The media have focused on a third runway and a sixth terminal because that is the easiest thing, I think, to communicate to the public. However, we are also consulting on a range of other things. What we are actually putting into the public domain is that our declared policy support was for a third runway from the Air Transport White Paper in 2003, confirmed in 2006, but we said that we would only go through with that if we were confident that we could meet the strict environmental standards on air quality and noise that we believe are appropriate to be maintained. We have been doing the work on that. We have put into the public domain the scientific evidence and the data upon which we based our decision. That is what we have put into the public domain for scrutiny and that is what is being consulted. We are also looking at other aspects. The original proposal was for a 2,000 metre runway. That is now a 2200 metre runway. We are looking at mixed mode. We are looking at what is called the

Cranford Agreement, which goes back to the fifties. We are looking at alternation. So there is a range of additional elements about the capacity building with Heathrow, but the main ones are the third runway, the length of the runway and the air quality and noise, environmental protections that arise and need to be demonstrated for us to be able to say that that is exactly where we want to go and that we have the confidence in going forward.

Q294 Chairman: I will come back to Mrs Ellman, if I may, but I think Mr Stringer has posed you an interesting question. Mr Moor, you are having to pick up the short straw!

Mr Moor: Following the T5, the length of time it took to take the T5 inquiry through, the Government in 2002 consulted on its aviation strategy and in 2003 published the Air Transport White Paper, which set out a clear 30 year strategy for the future development of the aviation industry in the UK. In particular, in there it included the proposals around two new runways, one at Heathrow and one at Stansted. So I think the answer to the question is that the Government recognised this weakness and therefore responded to it in 2003 with the Air Transport White Paper.

Q295 Graham Stringer: When over the last ten years Members of this Committee, including myself, have asked BAA why they were not going for a third runway when Madrid were putting on two or three, I cannot remember all the numbers, Schiphol was putting on an extra two or three and Charles de Gaulle was doubling in size, they said to us, "Not our responsibility, Guv, it's up to the Government." What was the Government saying to BAA during that period? There were clearly discussions going on. It is clearly the most bizarre position for a private commercial company to say that it is up to the Government whether they have a major investment decision on something which is important to their future. Can you enlighten us on that?

Jim Fitzpatrick: I do not think I can shed any light on it directly for you, Mr Stringer. I think Mr Moor has tried to outline –

Q296 Chairman: Come now, Minister. I think you must have read yourself in with great care. Surely somebody gave you just a hint of what other ministers have decided?

Jim Fitzpatrick: Forgive me, Chairman, I was going to say that I thought Mr Moor had given an explanation as to certainly the last five years and that indeed the decision was delayed as a result of the planning –

Q297 Graham Stringer: Minister, I am asking a different question. I accept what the White Paper in 2003 said. It said we wanted a runway. What I am really asking is what the Department for Transport said to BAA so that they did not ask for one before, because they were saying the ball was in the Government's court, however strange that is, and I would like to understand why, because we are in a situation which I find disturbing. Firstly, the country

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has lost its position in the aviation world. Heathrow is now not as prominent in world aviation and European aviation as it was. Secondly, at the T5 inquiry BAA said they would not have a third runway, which upsets people, quite reasonably, if they believe they are told an untruth. I want to understand why the country is disadvantaged and why those statements were made.

Mr Moor: If I can just clarify the process back in 2001 and 2002, a number of airport operators and other people put in a number of proposals to the Government around new airports and increases in passengers to existing airports. BAA obviously put in a proposal at that stage for a third runway and it was considered as part of the White Paper and was consulted on.

Graham Stringer: Come on, this Committee is an intelligent committee.

Chairman: More or less, yes!

Q298 Graham Stringer: Its Members are intelligent and they know, because we asked the questions of BAA and ministers over that period, that Heathrow was falling behind in its capacity, not just terminal capacity but runway capacity. There are some intelligent people in the Department for Transport who also viewed that as a problem. Why were the Department for Transport not promoting that and what conversations were they having with BAA? You cannot come to this Committee and tell us, "We thought about a third runway at Heathrow in 2001/2002." It is just not credible.

Jim Fitzpatrick: But at that time, as you say, BAA was saying that it did not want –

Q299 Graham Stringer: It was saying it was up to you collectively as the Government. What conversations were you having?

Mr Moor: I cannot comment on what was happening before 2001.

Q300 Graham Stringer: Why not?

Mr Moor: Because I am not aware of what conversations were happening then.

Q301 Graham Stringer: That is even more incredible, that you have not looked at the background. My guess is that the briefing for this, and when you looked it up, went back to the 1985 White Paper. Come on, we have had permanent secretaries here who have taken us through all sorts of histories. It is just not credible that a senior official comes here and says, "I don't know what happened before 2001." Please treat us seriously.

Mr Moor: I think my answer was post—once Terminal 5 got planning permission to be expanded, that is the time when BAA started the conversations around the future development of Heathrow, which ultimately went into the SERAS consultation in 2002, but it was not until the T5 planning application had been approved that there was consideration around what was for further development at Heathrow after that.

Q302 Graham Stringer: It is not credible, is it? Is it not really that the strategy was, "We get T5 out of the way and then we will go for runway 3," and that is to the disadvantage of the runway and to the disadvantage of the credibility of government generally, not just government of my political colour but government generally? Is that not the case?

Jim Fitzpatrick: That is a conclusion, Mr Stringer, which you may very well wish to draw. What we have been trying to outline is that from our point of view we have a very clear policy, which is to support the third runway. We have been doing the work to demonstrate that that could be done within the environmental protections we said were required when we published the White Paper in 2003 and that is what we are explaining as part of the public consultation at the moment.

Q303 Graham Stringer: What I want to believe about my Government is that they were thinking hard in the mid-1990s and beyond about the capacity of Heathrow Airport, and what I seem to be hearing is that you either do not know about it or nobody was thinking about it. It just is not credible and what I really want to understand is what were the dialogues going on between Government and BAA. Would you reveal those to us if you go back and you look at your very dusty files on these matters?

Jim Fitzpatrick: I would much rather put my hands up and apologise for the fact that I do not know rather than accuse previous ministers and officials of saying they were not discussing it, because I am sure they were, and I am very happy to go back to the Department and to research the documentation which was available at that time and to supply the background information from the 1985 White Paper forwards for the benefit of the Committee, but in terms of being able to cast light on that which was being discussed in the time period you are talking about, I can only apologise, Chairman, because I do not have that information at the moment.

Q304 Graham Stringer: I am grateful for that and I look forward to that information with great interest, because although we should look forward it is important to understand why we have got into a situation where people are annoyed because they are told one thing and the airport is not as good as it otherwise could be. Can you tell us why we do not go for a second runway at Gatwick, as opposed to Stansted?

Mr Moor: I can explain. In the last planning application at Gatwick Airport there was the local planning condition put on Gatwick Airport which said that a second runway could not be built before 2019. At the time of the Air Transport White Paper the Government looked at that condition and concluded that it supported development at Heathrow and Stansted and it would not seek to challenge the planning condition at Gatwick before 2019.

Q305 Graham Stringer: Did you take legal advice as to whether or not that planning decision, the planning agreement I suspect it was, was breakable and changeable?

Mr Moor: I am sure at the time legal advice was taken, but the decision at the time was to not pursue the development at Gatwick. It was considered the sustainable approach was to go for two runways in the South East. Despite the fact that air traffic forecasts showed three runways were required in the South East, only two were approved and they were chosen as Stansted and Heathrow.

Q306 Graham Stringer: Is there any prospect of you looking at Gatwick, because with the length of time these inquiries take—I know we are trying to speed them up—talking about 2019 is not ridiculous with Gatwick, is it?

Mr Moor: What we say in the Air Transport White Paper is that if development at Heathrow is not possible following this consultation, then the Government will look at the options for development at Gatwick.

Graham Stringer: Thank you.

Q307 Clive Efford: We have heard a lot of criticism from the airlines of BAA. Is the Government aware of them, and what assessment has it made of these criticisms?

Jim Fitzpatrick: Are we talking about general terms, Mr Efford, or are we talking about Heathrow in particular?

Q308 Clive Efford: There has been a lot in particular about the response to the heightened security measures, recruitment, the lengthy queues at peak times and the inability to be able to respond to them.

Jim Fitzpatrick: Yes, thanks for that. We certainly are aware of them. The Department only last week published this document, “Improving the Passenger Experience”, which was issued for discussion by the Secretary of State specifically to start addressing the concerns and criticisms which were being expressed by individual passengers but also airlines in an attempt to start defining exactly where the problem areas were, where the pressure points were, what could be done to improve the situation. We have been in regular dialogue with the industry, both airports and airlines, over the intensified security as a result of the plots last August, the imposition of the restriction on the “one bag” rule, which created problems, the additional immigration pressures for people returning to the UK, to do what we could to try to make sure that those pressures were relieved as best as possible within the restraints that were put in place, that we shared best practice across the country because some airports seemed to be dealing with it better than others, but also that we looked to see what we could do by way of improving the situation with additional recruitment, with better training, with the procurement of more scanners, for example, for the security comb, and indeed more sophisticated technology in terms of being able to screen and the material, whether it is bags, jackets, shoes, or whatever, asked to be deposited by the

passengers. So there is a very comprehensive examination going on of the passenger experience to try and support the airlines. We are conscious, obviously, that Heathrow, with the opening of T5 next March, should see a major stepping stone towards fundamental improvements of the experience at Heathrow. Subsequent to that, Terminals 1 and 2 will be replaced eventually by Heathrow East by 2012 in time for the Olympics and major refurbishments will be going on at the other terminals, so Heathrow will virtually be rebuilt by between 2012 and 2015 next year⁴. So in relation to the major problems which are being expressed, focusing on Heathrow, we believe there will be an immediate pressure relief next March when T5 opens and gradually that situation will improve considerably. But this document which we publish and the discussions which we have on an ongoing basis between ministers, officials, airports and airlines are very much addressing those concerns which we are very conscious of.

Q309 Clive Efford: We have also heard a lot from the perspective of passengers and their experience of passing through airports. In light of the criticisms there, do you think BAA has performed well?

Jim Fitzpatrick: We certainly are of the opinion that it is improving and the additional recruitment, the procurement of the latest technology, the additional machines which are being put in place, the experience post-August 2006 and post the Glasgow Airport attack demonstrates that there is a real willingness on behalf of BAA to acknowledge the shortcomings which exist in the airports and their requirement to deal with the additional pressures which have been caused as a result of the security threat being raised and the actual experience of Glasgow. Monitoring their recruitment procedures and the procurement of equipment, the amounts of money which they are clearly investing in the technology as well as extra staff, does give us confidence that they are aware that the situation has to improve, and indeed they are carrying that out as best they can.

Clive Efford: Given the responses of various airports to heightened security the summer before last, Manchester seemed to have systems in place. We have heard at a previous inquiry which this Committee undertook that Manchester seemed to have systems in place which responded quite well, but BAA did not seem to have similar success. Why do you think that was?

Q310 Chairman: Do you want to make a guess, Mr Moor?

Mr Moor: If I could just explain a couple of things. Obviously, we recognise that BAA has had problems with its passenger experience, as identified in the publication, but I think we also recognise that a lot of those problems are due to capacity constraints at Heathrow in particular and the fact that the airport is already operating at 40% above capacity, so unlike some other airports in the country where they have

⁴ Note by witness: Delete “next year”

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had the ability to expand their security comb because they have a more flexible use of space, I think BAA has suffered from that. One of the things I would say, though, is that we fully support CAA's proposals around having more transparency of passenger experience information at the airport and for airlines, but also CAA is currently consulting on quite significant rebates if BAA fail to deliver the passenger experience going forward into the next price cap review. So it is now looking at much tougher queuing times, 99% at less than ten minutes, 95% at less than five minutes, and there will be quite considerable penalties on BAA if it fails to meet those targets in the next quinquennium.

Q311 Clive Efford: The imposition of those increased penalties would suggest that there is some sort of dissatisfaction with performance, would it not?

Mr Moor: I think certainly the Competition Commission's report did say that it felt that the CAA's penalty system had not been sufficiently robust to improve the customer experience, and I think that is why the CAA is consulting on a tougher system in the next quinquennium.

Q312 Clive Efford: You are not suggesting to the Committee that the constraints of space were the major contributors to poor performance, are you?

Mr Moor: No, not at all. What I am suggesting is that there is a lot of different factors in terms of looking at different airports. Some airports have responded very well, some airports have not responded quite so well, but I think what you do have to do is to look at all the different capacity constraints and other operational constraints and take a view about where the airport is and whether it is improving or not, but I recognise that BAA has had serious problems at certain of its terminals at Heathrow in particular.

Q313 Clive Efford: Do you think that all the procedures which have been put in place now are going to address the problems we have experienced over the last, say, year and a bit, two years?

Mr Moor: Certainly BAA is quite confident that it has got a plan now to address all of those issues. I think the CAA is also scrutinising that through setting target performance standards. I have no reason to doubt BAA's plan. I think it would itself admit that it has not fully implemented that plan yet and it is still recruiting people and still installing machinery.

Q314 Clive Efford: Just one last question: setting aside the major investment in the infrastructure, why are its buildings in such a dilapidated condition?

Mr Moor: I think that is a question for BAA –

Q315 Chairman: Oh, we asked them!

Mr Moor: BAA certainly has put in place an extensive plan of further investment in Heathrow Airport over the next five years including, as the Minister mentioned, Heathrow East, a completely

new terminal. By 2012 the vast majority of passengers will be going through new terminal facilities.

Q316 Mr Leech: Security issues are clearly the biggest issues as far as the passenger experience is concerned, but one other area is passenger comfort and one of the problems with a lot of airports is lack of sitting space. This, of course, is brought on by the amount of money BAA has to generate from commercial activity as opposed to from the airlines themselves. Has the Government considered possibly addressing the balance so that more money in the future might come from the airlines rather than focus on commercial activity, and therefore being able to provide better space for people to sit?

Jim Fitzpatrick: The CAA has outlined the price regime for the next five years, which is out at the moment for consultation, and it would certainly take into account the whole package of income which the airports would get both in terms of the retail charges from airlines, et cetera. So there is a complex formula to determine what is appropriate. I think the biggest frustration, and Mr Moor referred to it a moment ago, in terms of Heathrow is the fact that it is running so much at over-capacity that there are constraints on virtually everything, which hopefully will start to be addressed when T5 does open next year and there will be greater space for passenger comfort. The CAA's proposals on the passenger experience and the recommendation or suggestion in its consultation that the rebates system, the fines to be levelled on airports, be increased from the 3% at the moment to potentially 7% recognises that it is clearly concerned that airport performance has to improve and it is prepared to consider levelling much stronger, higher, heftier fines if the performance does not improve.

Q317 Mr Leech: Do you think then that the proposed increases being put forward by the CAA will actually help to redress the balance and provide more comfort for passengers, and do you also believe that T5 will actually provide enough seating spaces for the passengers it is going to attract?

Jim Fitzpatrick: On the last point, Mr Leech, when I visited T5 a couple of months ago seating was one of the statistics which was quoted by BAA, because it was a bit miffed that there was a report in one of the national newspapers which was suggesting that there was going to be very limited seating, and it was saying that there is more than enough adequate seating planned. So it is very confident that those figures will more than match up to scrutiny. I think, as we have been trying to say, there is confidence from BAA and we have no reason to doubt that the performance and the passenger experience will improve as a result initially of T5, but we are talking about a rebuild, a refurbishment programme which will run through to 2012 and therefore it is going to take some time.

Q318 Mrs Ellman: You said that the third terminal at Heathrow's runways would only be built if environmental and noise standards were met. Is it realistic that it would not go ahead because you were not satisfied with it?

Jim Fitzpatrick: We are very confident, given the examination we have made, the scientific data and the research which we have undertaken and collated that we can demonstrate to the satisfaction of the severest public scrutiny that those environmental standards can be demonstrated. We have put that out into the public domain, all the technical data. We have produced a summary document for people to express a direct, simpler opinion with a questionnaire, or they can submit their own, but we have also produced, and it is also available for anybody who wants it, all the scientific data and the evidence where we show that we have the confidence that we can meet these criteria. That is available to anybody who wishes to see it as part of the public consultation.

Q319 Mrs Ellman: So you are saying that you are satisfied now?

Jim Fitzpatrick: We are satisfied now. We said that we would not go forward with support for the third runway unless we could satisfy ourselves that we could meet the criteria on noise and air quality. The modelling is within the consultation documentation to demonstrate that we have satisfied ourselves and that that stands up to independent scientific scrutiny. That is now out in the public domain for further scrutiny and we have got no reason to believe that it cannot stand up.

Q320 Mrs Ellman: How will the proposed new planning bill going through Parliament now affect decisions on the third runway?

Jim Fitzpatrick: I think, as Mr Stringer alluded to earlier on, the expectation from the new planning regime is that it will make major infrastructure planning applications more expeditious, more efficient. We saw the delays which resulted in the T5 inquiry. We want to avoid that in the future, and the planning bill, the Planning Act when it comes through, ought to be a very important tool to make sure that that is indeed what happens.

Q321 Mrs Ellman: But what would you say to the people who allege that that quicker decision-making will stop people from having the opportunity to make objections?

Jim Fitzpatrick: It is my understanding that contained within the Bill there are the checks and balances within the system to make sure there is adequate and ample opportunity for people to be able to register their objections and their protests and for them to be properly weighed up by the authorities who will make the determination of planning applications in due course.

Q322 Mrs Ellman: Have you had many representations from business in support of a third runway?

Jim Fitzpatrick: I am not sure, having only launched the consultation in the past few weeks, that we are actually measuring it at the moment. We have conducted a variety of meetings with local resident groups, with NGOs, with the business community, with trades unions and with airports on the consultation to make sure everybody that knew—where it would be impossible that they did not know that the consultation was taking place—to stimulate the widest possible response to the consultation. I would be very surprised, given the pronouncements in the media when the consultation was launched, if we do not get a very strong response from business because the business passenger and the business community were as vociferous as any other group about the problems they were experiencing at Heathrow because of security problems and the state of the airport. So I would be very surprised if business does not respond strongly to the consultation, in fact I will go as far as to say we will be very disappointed if business does not respond to the consultation.

Q323 Mrs Ellman: The Prime Minister has made it very clear he wants to see that runway go ahead. Do you think that is inspired by business pressures on him?

Jim Fitzpatrick: No, I think the Prime Minister's support for the additional capacity from Heathrow is on the basis of the evidence which the Department has produced. For Number 10 the discussions which have been taking place across Government in the past three years demonstrate the importance of Heathrow as an economic hub, as our gateway, and the impact which the recent problems have been having on business travelling numbers, et cetera. We know that aviation is an expanding industry, we know how important it is as an indirect employer, as a contributor to UK plc, and I think the Prime Minister very straightforwardly accepts that the consultation we have issued is a consultation on behalf of Government and he is as convinced as we are that the additional capacity is necessary and we want to see it in place as quickly as we can.

Q324 Mrs Ellman: Are you convinced of that case against the people who say this will cause environmental damage?

Jim Fitzpatrick: We are convinced that the protections which we said had to be demonstrated—the noise contour, the European levels on air quality—will be demonstrably met. In the consultation documentation we show the numbers, we show the figures, we show the reducing exposure to 57 decibels and above, and we said that the noise contour of 127 square kilometres ought not to increase. We have put into the documentation why that will not increase. We have shown the noise⁵ quality figures in recent years set against the European targets and European limits which will apply from 2010 and again we have put that data on

⁵ Note by witness: Delete "noise" Insert "air"

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paper so that people can see it in the simplest possible form so that they can understand it and then they can comment on it.

Q325 Mrs Ellman: What about atmospheric emissions caused by increased flying?

Jim Fitzpatrick: Atmospheric emissions is another issue altogether. We have just completed our environmental cost assessment looking into that particular aspect. We are negotiating in Europe to try and make sure the emissions are included in the EU Emissions Trading Scheme. We were arguing that at Montreal, at ICAO, recently where we did not win that argument but we are continuing to press for aviation to be included in the EU ETS because this is a world problem and that which is happening above Heathrow is just not exclusive to Heathrow, it is spreading right the way throughout the atmosphere.

Mrs Ellman: Thank you.

Q326 Chairman: Is it very realistic to put a question in saying, "Adding a third runway is achievable within the noise contour limit of 127 square kilometres"? Do you think most of the people replying will have an instant picture of what 127 square kilometres look like?

Jim Fitzpatrick: No, Chairman. I am sure that would be an entirely fair criticism were that to just be the case, but we have supplied diagrams of what 127 square kilometres –

Q327 Chairman: I understand the footprint, but you see after all you have made it very clear that there is not a threshold noise level at which you say that there is an onset of significant community annoyance. So if that is the case, if there is not a level, why are you continually quoting the 57 decibel limit?

Jim Fitzpatrick: The 57 decibel limit was historically set by the Department as being the level above which noise was inappropriate, particularly for vulnerable groups.

Q328 Chairman: I understand that, but given the constant changes in aircraft, given the constant change in the footprint that you are discussing, which people may or may not completely comprehend unless they see where they are in relation to that footprint, are you absolutely certain the Department has got that particular 57 decibels level right, because people will want to know? Are we talking about the same things? When I go out in my garden in the summer and I cannot hear myself think, is that within your 57 decibels or without your 57 decibels?

Jim Fitzpatrick: I can understand that individuals may not be able to determine themselves whether –

Q329 Chairman: You are asking them, so it is realistic to put it in these terms? I am sorry to press you, but these are exactly the things which the average householder wants to know.

Jim Fitzpatrick: No, I think it is entirely an appropriate question, Chairman. What I am trying to say is that 57 was determined scientifically by the

Department above which noise became inappropriate, particularly for vulnerable communities. We had to have a benchmark at some point. That is where it has been for some time and that where we think it is appropriate. Thirty years ago two million people in London were exposed to 57 decibels and above. That is now down to about 550,000. We have projected in our documentation that that should fall to closer to 500,000 by 2020 because of, as you say, technological developments, quieter aircraft, et cetera, but of course there are more aircraft and one of the studies which we did commission, the ANASE report, demonstrated that people are less tolerant of noise these days than they were before, all kinds of noise, but they did not say that we were wrong in setting 57.

Chairman: No, although they did say you should not use their figures as a basis for calculating, did they not? All right, we will pass quickly over that.

Q330 Graham Stringer: I am interested in your confidence about the air quality around Heathrow. Is it the methodology of measuring the oxides which has changed, or is it that the air quality has actually improved?

Mr Moor: Chairman, if I could answer that?

Q331 Chairman: Mr Moor, we know you are not just here as a pretty face!

Mr Moor: Thank you very much. What we have done is we have modelled the forecast going forward to 2015 and 2020. The forecasts show there will be a significant improvement in air quality around the airport in those time periods, so by 2020 all of the areas around the airport will be meeting the EU air quality standards and the main reason for that is the improvement in vehicle emissions from the Euro 6 compliance.

Q332 Graham Stringer: There was some doubt that the original figures were accurate because of where the oxides have actually been measured and I just wanted to know whether it was improved measurements or whether it was actually a different measurement. When the previous Secretary of State was here discussing the Open Skies policy, Douglas Alexander, he seemed a bit flummoxed when we asked him what the implications of that will be on the regional and Scottish airports. We asked at that time whether a study would be done on the impact of open skies, because it would be more difficult to get into Heathrow in all probability. Have you done such a study? If you have, can you let us in on what it showed?

Mr Moor: No, we have not done a detailed study. What we have done is we have been speaking to the airport and to ACL, who are the slots allocators, to look at what the impact would be immediately. What we are seeing is a relatively small impact next year as people primarily move aircraft away from Gatwick towards Heathrow or new airlines come into the marketplace. I think our forecasts are that that will continue to grow. The transatlantic marketplace will continue to grow under the EU—US Agreement and that is one of the main reasons

why we need the additional capacity from a third runway in order to keep the connections on the short-haul side of it.

Q333 Graham Stringer: Believe me, I am on-side in supporting a third runway. I just think that if we are going to see a negative impact on the regions, and Scotland and Northern Ireland, then you should share that information because you are much more likely to get the support of those regional and Scottish airports for a third runway if you tell them that life is going to get worse. So will you share that information with the Committee and the world in general, and possibly do some more studies?

Mr Moor: I think certainly we will share with devolved administrations any evidence we have. However, this is evidence which is fairly speculative by its nature. Obviously the airlines will have their own strategies. We can put in place some forecasts around what we think might happen, but it is up to the airlines to make a decision as to which are the most commercially viable routes they will be flying.

Q334 Graham Stringer: But it is up to the Government, which is now in favour of a third runway, to put the arguments as robustly as it can and this must be evidence in support, so I would have thought it was worth getting some more rigorous studies and not just rely on the airlines, which you could share with this Committee and the English regions as well as the devolved administrations. I would ask you, Minister, whether you could agree to that?

Jim Fitzpatrick: We will certainly look at that, Mr Stringer. One of the groups which we have had in as part of the consultation is the regional development agencies of England and we have spoken to them because we recognise the impact on regional aviation as well as through the devolved administration areas as well, and this is important for them, too.

Graham Stringer: Thank you.

Q335 Chairman: You will realise, of course, that it would be helpful to look at what the French do at Orly in relation to their regional airlines, where they protect the interests of regional flights. This is also the case in relation to a number of other major airports, so it would be extraordinary if we were the only people refusing to make special arrangements for regional flights, because there is no commitment on the part of any of the big airlines, who are simply going to use every slot they have got at Heathrow for transatlantic flights, and there is neither commitment nor understanding of the essential economy of the regions and the effect excluding regional airlines from Heathrow would have upon the general political development.

Jim Fitzpatrick: I think that is a very fair point, Chairman, and one of the drivers for the additional capacity at Heathrow was to make sure that Heathrow has the ability to take the expansion domestically as well as internationally because

aviation, as we know, is growing and if Heathrow does not get that capacity then there is a whole number of distortions which will take place.

Q336 Chairman: Yes. It is a very simple message really. The Members of this Committee would certainly take an interest if we found that the expansion of Heathrow under the absurd EU rules meant that very many large American airlines were getting into Heathrow and that for people flying either from the regions or from the devolved administrations it was not possible to land there. I leave you with this message.

Q337 Mr Hollobone: Would the Minister agree that airport regulation in this country is far more complicated than it needs to be? You have the case at the moment where the Civil Aviation Authority can propose price controls but their decision is then automatically referred to the Competition Commission, which is an automatic referral mechanism which does not exist in other regulated industries such as water and electricity, for example. In last week's evidence the CAA agreed with my point that the system was over-regulated and they were of the view that Her Majesty's Government might be looking to do something about this once the Competition Commission has finished its market inquiry. Could the Minister confirm if that is the case and what steps are being taken, perhaps in conjunction with the Department for Business Enterprise & Regulatory Reform on reforming this system of regulation?

Jim Fitzpatrick: The Secretary of State has invited Sir Joseph Pilling to carry out a strategic structure review of the CAA. At the same time the OFT and the Competition Commission's review looking at the regulatory framework, the price regimes, et cetera, is also underway, so within a short period of time I think we will have an examination of aspects of regulatory control within the UK in terms of how the CAA itself operates, how it is structured, how it works, as well as the regulatory and pricing regime and arrangements. They are all overseen by the Competition Commission, and alternatively the OFT, so we are in discussion on a regular basis with colleagues at the BERR and other departments. I think there is an acceptance, an acknowledgement that it is time the situation was reviewed, particularly in terms of the CAA, which is why Sir Joseph Pilling has accepted the invitation to carry out that work on the Department's behalf.

Q338 Mr Hollobone: What impact do you expect the consultation on capacity at Heathrow is going to have on the Competition Commission's own market inquiry?

Jim Fitzpatrick: The Competition Commission's inquiry will obviously determine future regulatory and pricing controls. The additional capacity at Heathrow very much determines the ability of the airport to function for the twenty-first century, whereas at the moment it possibly cannot, so I think they go hand in hand. In terms of making sure we have an aviation sector which is fit for purpose for

28 November 2007 Mr Jim Fitzpatrick MP and Mr Jonathan Moor

the twenty-first century, we need to make sure that the price regime is right, that the regulatory and structural controls are right and that the airports themselves therefore have an ability to be able to expand and flourish and do the job they are supposed to be doing, which is looking after the passenger as well as making sure that the industry is profitable and flourishing.

Q339 Mr Hollobone: In last week's evidence the CAA said that they would like the issue of inter-terminal competition to be looked at, having competing terminals within Heathrow Airport. In today's evidence, BA said that was not possible and they did not want it, perhaps not surprisingly. What is the Department's view on the merits of competition between the different terminals and what research has your Department done into the possibility of adopting a system similar to that in operation at New York's JFK Airport?

Mr Moor: The OFT reference to the Competition Commission specifically looked at the existence of development restrictions, so that is something we would be expecting the Competition Commission to be looking at. They will, therefore, be looking at the possibility of inter-terminal competition. One thing I would say is that because they are looking specifically at development restrictions this is not as easy as it is maybe in some places like America. If you look at JFK Airport, they have nine different terminals there. We already know how difficult it was to get a fifth terminal at Heathrow Airport, so one of the key problems for us in the South East is that the development restrictions and the capacity restrictions will make it very difficult to have inter-terminal competition within an airport.

Q340 Chairman: Finally, can I just ask you one thing, Minister: are you aware that the new owners of Heathrow considered themselves shocked by the new pricing regime which is being proposed?

Jim Fitzpatrick: I know that when the proposed price regime was put out to consultation last week there were conflicting reports in the media. *The Telegraph*, I believe, took the view that the attack was on the airports and *The Guardian* took the view the attack was on the airlines.

Q341 Chairman: Forgive me if I am not too interested at the moment in what journalists say. If I could just draw your attention to the fact that we are told here this afternoon in evidence by the relevant authorities that they regarded these changes as being, I think "shocking" was the word—"shocked". Am I misrepresenting them? They were shocked by this.

Jim Fitzpatrick: I was perhaps being too elaborate in illustrating a point, which is that if both sides, both the airlines and the airport, were both satisfied the Competition Commission's view is that maybe we are getting it about right because we are not favouring one or the other. There is a consultative period to take place. Evidence would have to be submitted. People will want to express points of view to try and influence the outcome of that, whether it is to increase the level of charges or to reduce the level of fines. That is the dynamic which will be taking place over the next few months, so maybe I will be surprised if Ferrovial/ADI did not express a point of view that they wanted to see a bigger return for their investment.

Q342 Chairman: Would you be shocked if somebody bought an asset which they did not know how they could exploit?

Jim Fitzpatrick: I am confident of the future of BAA with the arrangements which were put in place when Ferrovial bought it. We are confident that the future is secure and that we are going to get the investment, that the industry is able to sustain the money which will be required to improve our airports and that Ferrovial will get a decent return as a business operation.

Chairman: Can I congratulate you, Minister? I have known you a long time and I know you are an extraordinarily clever fellow, and I never knew you were a diplomat! I hope you will come again.

Written evidence

Memorandum from Mrs P and Mr R Mathewson (BAA 01)

I am writing as a private citizen and I want the government to scrap its aviation White Paper. Any increase in flights at Heathrow or any other airport is extremely irresponsible. The *Stern Report* made it plain that we cannot afford to go as we have been. Economic arguments for expansion at Heathrow do not stand up.

For the sake of my children and grandchildren I hope that the government will take Climate Change more seriously and they can start with BAA and Heathrow.

October 2007

Memorandum from Alan Godsall (BAA 02)

1. OUTWARD JOURNEY: BA1434

1 October 2007	07:50	Boarded this flight to Edinburgh in good time.
	08:35	Plane was pushed back from its stand, some 40–45 minutes late. The explanation given was that a tractor could not be found to push the aircraft off the stand.

2. RETURN JOURNEY: BA1463

1 October 2007	19:20	Boarded this flight to London.
	19:50	Plane left the stand. The pilot explained the delay was due to flight traffic at Heathrow.
	21:15	Arrived over Heathrow and circled for 10 minutes.
	21:25	Landed at Heathrow but no parking bay available and had to
	21:35	wait a total of 10–12 minutes for buses to arrive

3. CONCLUSION

A total of about two and a half hours flying time was extended by a further hour and a half by direct/indirect incompetence of BAA.

October 2007

Memorandum from Gatwick Area Conservation Campaign (BAA 03)

1. GACC, founded in 1965, has as members over 100 Councils and amenity groups covering an area of about 20 miles radius from Gatwick Airport. Our aim is to protect the environment of the surrounding area.

FOREIGN OWNERSHIP

2. For over 40 years we have been dealing with BAA. While we often disagreed with BAA policy, we found that, whether as a publicly owned industry or as a British company, they were always concerned to protect their reputation with MPs and with Parliament. (They were appropriately terrified of being examined by the Chairman of the Transport Select Committee!) The fact that they needed to prove a good environmental record gave us some leverage. With foreign ownership that situation exists to a lesser extent.

3. This summer BAA has received unprecedented criticism in the press for the shambles at Heathrow and, to a lesser extent, at Gatwick. Some of the criticism is unfair because part of the responsibility for the queues and lost baggage lies with the airlines and part with the new security regulations. But what has become clear is that Britain cannot rely on a foreign company, whose main aim is to increase its profit, to provide a first class service for passengers—nor to protect the environment.

GATWICK FOR SALE?

4. There have been rumours in the press that Gatwick is to be sold off. It seems unsatisfactory that such a major piece of national infrastructure can be bought and sold as if in a car boot sale, with no conditions laid down to protect the public whether as passengers or as residents.

5. Some of the environmental regulations affecting Gatwick are laid down by government. The legal agreement preventing the start of construction of a second runway before 2019 applies to whoever owns the airport. But many environmental safeguards are contained in a legal agreement signed in 2001 which expires in 2008. We are concerned that a new (foreign?) owner may not be keen to renew it, and indeed competition between the London airports could provide more incentive to cut corners on environmental protection.

6. West Sussex and Crawley councils, which are at present seeking to negotiate a new agreement with BAA, have no power to insist that it has any real teeth. They need Government backing.

7. You may like to recommend that the Government should state that any purchaser of Gatwick will be required to fulfil certain minimum standards for passenger service and for environmental protection. The latter should be an improvement on the legal obligations agreed in 2001. If the purchaser does not sign up to a reasonable agreement, the Government should impose the necessary regulations.

INVESTMENT IN NEW CAPACITY

8. We have no strong views on whether the structure of BAA should be changed but we would consider it regrettable if the company were to be shaken up again on the basis of bogus economic arguments.

9. It is often said that a purpose of breaking up BAA would be to stimulate more investment in new capacity, mainly new runways. Such an aim, however, runs counter to the vital need to limit climate change damage. Aviation in 2005 accounted for 13% of UK climate change damage¹ and this percentage is growing rapidly. We have undertaken a study which shows that aircraft using Gatwick are responsible for more climate change damage than all other activities in the whole of Surrey and West Sussex.²

10. Selling off Gatwick would do nothing to increase investment in new runway capacity. The Air Transport White Paper ruled out another runway at Gatwick, unless Heathrow was unable to meet certain environmental conditions. Construction of a new Gatwick runway before 2019 is also ruled out by a legal agreement, which the Government decided not to overturn. An efficient new runway is also ruled out by the physical constraints of nearby towns and high ground.

11. Both main Opposition Parties have also ruled out any new runway at Gatwick. That makes it unlikely that any company purchasing Gatwick would do so in the hope of increasing capacity by building a new runway.

AIRPORT CHARGES

12. Due to CAA regulation, charges at BAA airports, such as Gatwick, are among the lowest in the world, and are well below market levels. By giving an artificial subsidy to airlines, this helps to inflate the demand for air travel, and increases climate change damage. It also compounds BAA dominance.

13. Breaking up BAA, and relaxing CAA regulation, would mean an increase in airport charges, not a decrease as some airlines appear to believe.

14. Any proposals for the future of BAA should include charging market rents for landing and take-off slots, subject to a government levy on the consequent profits (although we recognise that international agreement might be necessary).

October 2007

Memorandum from T Martin Blaiklock (BAA 04)

I write with respect to the Transport Committee's Inquiry into "The Future of BAA", currently owned by Ferrovial of Spain.

1. It is clear that there are certain monopolistic aspects of BAA's operations, particularly for residents and travellers living in the South East of England. For 90% of air travel, the choice of airport will either be Heathrow, Gatwick or Stansted, all owned by BAA.

2. For every pound spent on BAA airport projects in this region, however, there could well be another pound spent outside the perimeter fence to support the necessary supporting infrastructure development. With respect to a third runway at Heathrow, it could be more. Hence, many aspects of BAA's business development impact the public purse, much more so than was envisaged when BAA was privatised in July 1987.

¹ Answer to PQ 2 May 2007.

² See www.gacc.org.uk

3. There is also another important feature of today's scenario, and that is ownership and, in that context, the control of UK airports assets.

4. Why is this important? To many, money is fungible wherever it comes from. True. However, the control of such money and the use it is put to is just as relevant, particularly in the context of regulated public services, as airports provide.

5. UK regulatory authorities seemingly impose no control over the ownership and control of public service utility assets through some form of "fit and proper person" test, as do other countries. In the UK, any investor,—saint or crook,—(a) who has the money, and (b) wherever he may reside,—usually a tax-haven outside public scrutiny and operating under a liberal governance regime,—can own and control an airport!

6. BAA is currently owned by Ferrovial, through a labyrinthine series of special purpose companies (*viz* their May 2006 website presentation). This series of special purpose vehicles is primarily set up to:

- (a) minimise UK tax exposure, albeit the ability of Ferrovial to write-down "goodwill", as normally is allowed for in such acquisitions in Spain, is being questioned by the EU Commission under State Aid provisions;
- (b) to limit liability of the shareholders, ie Ferrovial (parent); and
- (c) to allow, most probably,—as for many other private equity operations,—the Ferrovial equity to be injected primarily as shareholder loans rather than pure equity to protect the future dividend stream to the parent and to minimise UK tax (again).

[Note: it is difficult to confirm this aspect as the accounts are not in the public domain.]

Item (b) is particularly important should there be an accident at one of BAA's airports, when negligence on the part of the airport operator may be the cause and normal insurance provisions are inadequate.

7. There is, nevertheless, one further disturbing aspect of the BAA scenario. Ferrovial is a quoted company on the Madrid Stock Exchange. It is, therefore, subject to certain governance criteria, albeit not as strictly as if it was quoted on the London Stock Exchange.

8. Ferrovial, however, is owned,—and therefore controlled,—58% by the del Pino Y Moreno family interests, directly and indirectly (ref the Ferrovial 2006 Annual Report). It is clear from BAA's 2006 Financial Reports that "the family" control the Board and senior management decisions.

One concludes, therefore, that Heathrow, Gatwick and Stansted are controlled by a family company, who do not necessarily have to follow the relatively transparent corporate practices that we might expect of a quoted UK plc, as was BAA previously.

9. One possible outcome of the Competition Commission's Inquiry into BAA could see the break up of BAA. So be it. This may mean Ferrovial has to sell one or more of their UK London airports.

Let us assume that they sell Stansted (or even Gatwick) for £3–4 billion, as some reports have forecast. Ferrovial can then use that cash to easily buy back, with no constraint other than market forces, the 42% outstanding Ferrovial shares they do not own on the Madrid Stock Exchange (value approx £3.5 billion.), and take the company 100% private, probably offshore and domiciled in a tax-haven, totally outside UK public scrutiny and governance. Furthermore and worryingly, the current UK financial regulations could not stop such a development.

10. One only has to look at the ownership interests of Bristol and Exeter Airport by the Macquarie European Infrastructure Fund, a "brass plate" company domiciled in Luxemburg, to provide a precedent for such a move.

11. BAA/Ferrovial also controls the Heathrow Express Rail Link, as well as the Tubelines PPP (Piccadilly Line), the London Underground link to this airport!!!

12. As a UK traveller and citizen, I am concerned as to:

- BAA's ability to serve the national (strategic) interest in the future;
- the future commercial and financial health of these BAA airports; and
- the potential avoidance of public liability by such an airport operator.

The Chancellor of the Exchequer might also not be pleased by the reduction in tax revenues!!

The public deserve better accountability as well as service from BAA!!

I trust that you may take these comments into account in your deliberations.

Background: Martin Blaiklock has over 25 years experience of structuring, developing, evaluating and implementing the funding of public and private sector projects [ie PFI's, PPP's, BOOT's; PSP's, IPP's, etc] in infrastructure, energy, and the process industries.

Uniquely, he has worked for extended periods in: (a) an investment bank; (b) a commercial bank; and (c) a development bank. For the last 12 years he has operated as an independent consultant, both in the UK and internationally.

He has been involved in many major UK PFI & PPP projects, and was Expert Witness for the Parliamentary Enquiry into the London Underground PPP. He has contributed to many Parliamentary and National Audit Office Enquiries.

October 2007

Memorandum from Heathrow Association for the Control of Aircraft Noise (HACAN) (BAA 05)

INTRODUCTION AND SUMMARY

About HACAN

Heathrow Association for the Control of Aircraft Noise (HACAN) is pleased to have the opportunity to submit evidence to the House of Commons Transport Committee's timely inquiry into the future of BAA. Our organisation represents residents who live and work under the flight paths of BAA's Heathrow Airport. HACAN was formed over 30 years ago, and our membership is over 5,000. Our evidence focuses on Heathrow Airport because this is the area of HACAN's expertise, but this facility is so important to the company that we believe it will inform the Committee's inquiry into the future of BAA as a whole.

Our Submission: BAA should aim to make Heathrow the best, not necessarily the biggest

It is not our aim to force the decline or closure of Heathrow Airport. Many of the people whom we represent work at the Airport, or are otherwise dependent upon its success. But continued, exponential growth in the number of flights and passengers is unsustainable, either economically or environmentally.

We will argue in this submission that the problems Heathrow is currently experiencing stem, at least in part, from BAA's obsession with the size of the airport. This obsession overrides any real focus on the quality of the service BAA provides to its customers, to London or to the UK as a whole. We will argue that the solution to Heathrow's problems will be found not in further expansion but in improving the quality of the passenger experience. In short, Heathrow should aim to be the best airport in the world, not necessarily the biggest.

1. HEATHROW—LANGUISHING DOWN THE LEAGUE

1.1 London wants an airport to be proud of, and which will act as a catalyst for inward investment. Yet, the 2007 Annual World Airport Awards, made by Skytrax, gave Heathrow only two stars, classifying it as a "poor" airport. Munich was named as Europe's top airport, with Amsterdam in third place. Heathrow languished behind all of its key "rivals".

1.2 The Committee noted in its Eighth Report (section 57):

"Airports are generally not pleasant places to be. There are of course good and bad examples as there are in all industries, but in general the passenger experience of using the airport appears to have become worse over the past few years, significantly so in the UK since the security alert of August 2006. This has been a particular problem for BAA's airports—in a poll of 4,000 travellers conducted by online travel service TripAdvisor, Heathrow was voted the world's worst airport [72]."

1.3 The Heathrow experience for many people is reflected in the comments below—part of the survey conducted by Skytrax (2007)—where passengers were asked to rank Heathrow. Many gave it one star (very poor).

Heathrow Airport by Simon Smith

9 October 2007 Customer Rating: ★☆☆☆☆

I flew out of T4 this week. Although the security queue was short by Heathrow standards, it moved incredibly slowly, and took 30 minutes to clear. Once through security, it is basically a claustrophobic and expensive shopping centre. There were not enough seats, or perhaps there were seats but hidden somewhere to force you to spend more time in the shops. Overall, awful. Heathrow is sometimes accused of being a third world airport but this is unfair—most of the third world airports I've used are better.

Heathrow Airport by Peter Gleeson

20 September 2007 Customer Rating: ★☆☆☆☆

I usually avoid Heathrow at all costs. The security people were unfriendly, signposting poor, the place sad and run down. Many foreign travellers were genuinely upset by the poor staff attitude at security and immigration. On managing to get into the concourse area of the terminal and wait for my flight I went into one of the bars/cafes for a drink and bite to eat—food on the floor, tables full of empty glasses etc. On ordering and getting my very unmemorable meal I was asked to hurry up and finish and pay, as it was the end of the shift for the waiter. I suggested I'll pay the new waiter when he or she comes on shift. This was apparently frowned upon by management. The poor waiter then was forced to wait until I'd finished my meal and was ready to pay!

2. HEATHROW—A GOOD CUSTOMER EXPERIENCE: GOOD FOR BUSINESS

2.1 The BMI Chief Executive Michael Bishop summed up the way the current customer experience at Heathrow can harm business:

“Heathrow is still the world’s largest international gateway, but its owner, BAA, and British Airways have helped to completely trash its reputation, not only in the eyes of the British but worldwide. Heathrow now has the reputation formerly held by the British Rail sandwich, and that is hugely damaging. It is economic folly to inconvenience international businessmen so seriously that they give Britain a miss.” (*Daily Mail*, 6 August 2007).

3. BAA IS PURSUING THE WRONG DIRECTION FOR IMPROVEMENTS

3.1 While BAA does acknowledge some of the failings in the customer experience it provides, its website bounces along as if little is wrong:

“CUSTOMER SERVICES

Exceeding expectations

At BAA our mission is to provide customer service of the highest possible standards. All our staff are happy to help passengers with requests for assistance, whether it’s with the retail or operational side of the airport. We’ve also introduced a number of other practical service innovations . . .”

3.2 But, in order to attract business passengers, BAA is putting its faith much more in expanding the airport rather than improving the current facilities. The Committee’s Eighth Report noted (paragraph 60):

“Both BAA and Manchester Airports Group believe that the best way to improve the passenger experience of airports is to build more of them and to extend the ones which exist. They argue that this would mean larger passenger check-in areas, better security provision and more commercial space airside.”

3.3 The Committee noted in the same paragraph of that report that BA agreed with that approach, but that Flybe was critical of it:

“British Airways notes the ongoing problems at Heathrow where the primary cause of poor customer experience is lack of runway, terminal and apron capacity. Heathrow is permanently under stress because of its high utilisation. The effect of this is that when there is disruption of any type—be it weather, security, air traffic control problems, etc—the airport fails to cope.[79] Flybe does, however, warn against regional airports in particular building “expensive terminal buildings or grandiose infrastructure projects” when they should be concentrating on maintaining and improving accessibility.[80].”

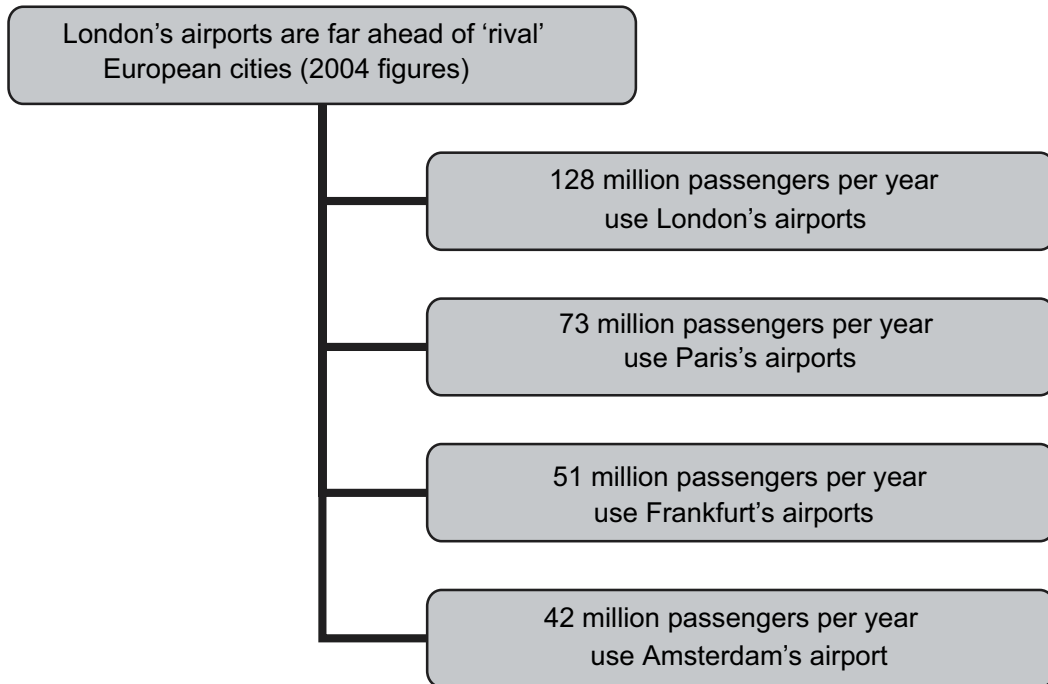
4. HEATHROW EXPANSION IS NOT A PRIORITY FOR BUSINESS—LONDON HAS PLENTY OF AIRPORT CAPACITY

4.1 In order to prove our case that it is big, consistent improvements to the customer experience at the airport that are in the best interests of Heathrow and of London, we need first to deal with BAA’s argument that it only by expanding the airport—more planes, a third runway, a sixth terminal—that Heathrow can cater for the needs of business.

4.2 BAA’s argument is that businesses will relocate to the other European cities with large hub airports—Paris, Amsterdam, Frankfurt and possibly Munich and Madrid—if Heathrow does not expand. The argument has made so repeatedly and over such a very long time that it has become received wisdom, not least in the UK Department for Transport. But there is a dearth of evidence to back it up. What evidence there is suggests the proposition is not true:

- Only 1% of members of the Institute of Directors think airport expansion is a priority (Transport Matters Survey by the IOD—January 2007);

- 78% of London firms are against expansion at Heathrow (London Chamber of Commerce Survey 2006); and
- Less than a sixth of London firms would even consider leaving London if the airport did not expand (London Chamber of Commerce Survey 2006).



4.3 What this suggests is that Heathrow is only one of the many factors business consider when deciding whether to remain in, or relocate to, London. International links are important to businesses, but are only one of several factors which influence their decisions. And, of course, it is important to remember that Heathrow is only one of the airports business can use to access London. For most business people it is access to London which is important, not generally the specific airport they use. When all London's airports (Heathrow, Gatwick, Stansted, Luton and London City) are compared with all the airports serving the so-called rival cities, it becomes clear just how much better is the access to London.

4.4 London businesses seem to understand this. BAA refuses to acknowledge it.

4.5 Furthermore BAA argues that, unless Heathrow expands, London will lose businesses to other cities with large and growing hub airports. Their argument is as follows: business likes to locate where there are flights serving a large number of destinations. If Heathrow is falling behind its "rivals" in the number of destinations it serves, London will become less attractive to business.

4.6 The two tables below, taken together, paint a different picture. Table 1 shows that Heathrow does serve fewer destinations than its key "rivals". Table 2 shows, though, that Heathrow caters for many more passengers:

Table 1

DESTINATIONS SERVED				
	<i>LHR 2006</i>	<i>CDG 2006</i>	<i>FRA 2006</i>	<i>AMS 2006</i>
Europe	87	99	114	115
North America	25	21	24	19
Asia	21	21	27	21
Africa	14	24	14	13
Latin America	9	12	13	12
Middle East	15	7	11	7
Total	171	184	203	187

Table 2

DEVELOPMENT IN NUMBER OF PASSENGERS (IN MILLIONS)

	2000	2001	2002	2003	2004	2005	2006
LHR	65	61	63	63	67	68	67
CDG	48	48	48	48	51	54	57
FRA	49	49	48	48	51	52	53
AMS	40	40	41	40	43	44	46
MUC	23	24	23	24	27	29	31
BCN	20	21	21	23	25	27	30

The fast-growing Munich and Barcelona are included.

4.7 What seems to be happening is that business and leisure passengers want to come to London even though Heathrow serves fewer destinations. Indeed, it seems that it is because the “rival” airports cannot attract as many people as Heathrow that they seem to be much more dependent on serving more destinations. The truth is that London is one of the world’s greatest centres of commerce, culture and tourism. It is London’s competitiveness as a city which attracts airline passengers, and Heathrow does not need to respond to every conceivable competitive challenge in order for London to prosper.

5. SO, WHY DOES BAA PERSIST WITH PRIORITISING EXPANSION OVER CUSTOMER EXPERIENCE

5.1 The answer must lie in BAA’s perceived self-interest. The evidence seems to show that the priority for business travellers is not expansion of Heathrow but an improved experience for the customer at the existing airport. Business is looking for a better airport, not necessarily a bigger one. BAA’s insistence on an expanded airport as the key to assist the economy would suggest it is confusing what it sees as in its own financial interest with that of the wider economy.

5.2 The Spanish company Ferrovial acquired BAA at a huge cost. It is clearly looking for a return on its investment. We believe this is the motive for its expansionist plans, not any concern about the health of the UK economy or the prosperity of London. It is revealing that, in its first year in charge of Heathrow, investment by Ferrovial fell at Heathrow at the very time when their revenue soared. UK-Airport-News.info reported (7 August 2007):

Investment drops and revenue soars at Heathrow in first year of Ferrovial ownership 07.08.07

Revenue has soared but investment has dropped at Heathrow in the airport’s first year under foreign ownership, *The Times* newspaper reports. The news will further fuel airline and passenger criticism over the poor state of the airport’s terminals and horrible passenger experience.

According to figures in the Ferrovial accounts, excluding the investment in the new Terminal 5, capital expenditure at Heathrow was £252 million in the year since it bought BAA. This is 15 percent lower than BAA spent on Heathrow’s infrastructure in its last year as an independent company. The decline in Heathrow’s investment comes as the airport, the world’s busiest international hub, is under fire over the poor state of terminals and long queues at check-in and security.

During the same period the revenue from Heathrow has grown to £1.232 billion from £1.077 billion, a rise of over 14%. It is unclear how much profit Ferrovial made from Heathrow compared with the previous management, as it reports using a different method.

5.3 Moreover, BAA is currently the subject of an inquiry by the Competition Commission which may force Ferrovial to divest itself of at least one of its London airports. Therefore, the company will wish to secure consents for as much additional capacity at Heathrow as possible so as to be able to compete with other London airports in the future. This is nothing to do with international competitiveness, and everything to do with Ferrovial’s commercial interests.

6. CONCLUSION

6.1 BAA Ferrovial’s insistence of giving priority to the expansion of Heathrow over improving the customer experience is purely self-interested. If it was acting in the interests of the wider economy, it would be listening to what business seems to be saying: it is the poor customer experience at Heathrow that is their main concern rather than a failure to expand. The conclusion must be that Ferrovial, the foreign company now owning BAA, has little interest in the wider economy of London or the UK. This is highly undesirable, given the fact that it owns seven airports in this country.

6.2 HACAN's vision is for a sustainable Heathrow no larger in terms of flights or passenger numbers than today overall. We want the airport to concentrate on long-haul destinations of the greatest commercial advantage to the economy of London, rather than chasing ever greater volumes of short-haul and low-cost passengers. We want the airport to provide worthwhile, well-paid and sustainable employment to people in London and the South East, and to strive towards minimising the environmental impact of its activities. We hope that the Committee will make recommendations supporting our views.

November 2007

Memorandum from the Royal Aeronautical Society (BAA 06)

SUMMARY

- The airports operated by BAA, especially its London trio are national assets, often competing with other European hubs.
- Heathrow is “special” as the focus of major European and global networks and a key part of the UK national economy. Operating at total capacity, it has acquired a justified reputation for poor value for money for airline and passenger users. Modernisation and expansion is essential and should be seen in the wider context of the UK economy as a whole.
- While the economic and environmental value of an integrated UK transport system must be recognised, there is a good case for operating Heathrow as a separate entity to encourage continuous improvements in efficiency and standards.
- The vital national role of these assets should be paramount, and not threatened by excessive debt or the expectation of near monopoly rates of return. The public interest requires a continual monitoring and regulation of UK airport operations to promote sustainable growth in UK civil aviation and the adoption of strategies that best serve the wider UK economy.

MEMORANDUM

1. The Royal Aeronautical Society (RAeS) is the Learned Society for the Aerospace and Aviation community. Based in London, it has a worldwide membership of over 19,000, with over 13,000 in the UK. Its Fellows and Members represent all levels of the aeronautical community both active and retired. Through its various Boards and Committees, it can draw upon considerable experience and expertise in aviation matters, including a Specialist Group on Air Transport. In addition, the Society has over 160 Corporate Partners.

2. The airports owned and operated by BAA are vital national and regional assets. In particular Heathrow is the premier gateway to the UK, at the centre of European and global networks. While there is a strong trend for airlines to operate more point-to-point services, Heathrow is likely to remain a key hub airport notably for the UK. Together with Gatwick and to a lesser extent Stansted, BAA's group of London airports should be regarded as an integral feature of Britain's transport infrastructure. Glasgow, Edinburgh and Aberdeen provide a comparable function for Scotland.

3. UK airports, and especially the London trio, are in competition with other European hubs, notably Paris Charles de Gaulle and Amsterdam Schiphol. Paradoxically these may in fact be more expensive than Heathrow for the operator, but they have superior passenger handling and better transport connections than most UK airports. From a UK passenger point of view, certainly from those living at a distance from London with limited access to major UK airports, connecting through other European hubs may be more attractive. However, failure to address the limitations of the UK's airport provision, particularly for London as a world financial and business centre will have a deleterious long-term impact on Britain's competitiveness. Heathrow is effectively full, and operating close to 100% capacity, it is clearly vulnerable to the smallest problem (such as the recent minor collision of two aircraft) that can have a disproportionate affect on operations.

4. The expansion and modernisation of BAA's airports is therefore vital for UK civil aviation and the wider economy. The failure over the years to expand Heathrow in a timely way has enabled airlines and the airport authorities to charge “scarcity prices”, which have enabled the airport to become, according to Robert Milton, Chief Executive, Air Canada “the world's greatest money making machine”. The Competition Commission's recommendation for above inflation increases to landing charges at its airports satisfied neither BAA nor the airlines.

5. Heathrow may not be the most expensive airport in Europe, but criticism has centred on value for money and the quality of service that BAA has delivered for its passenger and airline clients. From a passenger perspective, highlighted by the BAA's response to security and other recent problems at Heathrow, overall service delivery has been poor with it regularly placed towards the bottom of passenger surveys. Clearly some of the immediate problems facing Heathrow stem from its original design and the huge increase in traffic it has experienced over the last decade. It should also be noted that the airline operators also have responsibilities for the smooth operation of passenger processing, for example opening check-in facilities earlier to cope with longer security clearance times.

6. The opening of Terminal 5 and other planned improvements in terminal facilities will undoubtedly help to improve performance, while of course further enhancing its commercial value. In the future a third runway and T6 at Heathrow to serve domestic and European routes should further underline the value of Heathrow as a hub and would underpin London's position at the centre of an international air transport network with all of the economic benefits that this implies. Similarly, the planned parallel improvements at Stansted and particularly Gatwick would also facilitate a more balanced competitive environment, with both likely to benefit from new services launched following the US-EU Open Skies Agreement.

7. Nevertheless, the development of the "London hub" of airports must be seen as collective enterprise. This is not helped by the absence of poor direct transport links between the three airports such as the RER connection between Paris Charles de Gaulle and Paris Orly. It is not clear whether the construction of Cross Rail in London will improve matters other than to connect Heathrow with City Airport.

8. While the Society would welcome a measure of increased competition between airports as a means of improving the quality of services if airlines and passengers were able to make a comparison of the service quality offered by different airport operators, the development of UK airports must be seen in terms of a national network. This is especially important when the environmental impact of airport developments is to be mitigated, the expansion and improvement of UK air services to be achieved in a sustainable manner. In this respect, there should be careful regard to the cost of public transport to airports. Although not always under BAA's control, there is often a significant difference between the costs of travelling to London airports by rail compared to similar journeys in Europe. This may reflect differences in rail subsidisation policies, but attention should be given to more closely regulating the prices charged for dedicated public transport connections as an environmental issue.

9. On balance, the Society contends that larger benefits would flow from reform of the regulatory regime to ensure an adequate commercial return on operational assets. Though the changes to the ownership would probably increase the aeronautical charge at Heathrow reductions in the present excessive fares, due to increased competition between the airlines, and lower slot costs, would leave users much better off overall. Further improvements and perhaps reductions in charges might also follow from these changes if BAA's airports were allowed to operate a "dual till" system where operational facilities are assessed separately from overall revenue generated by the airports.

10. New and modernised facilities are expensive, as reflected in BAA's current investment in T5. As such the operator is entitled to make a commensurate return in order to recover these costs. On the other hand, the vital national role of these assets should be paramount, and not threatened by excessive debt or the expectation of near monopoly rates of return. Studies have shown that airport operations absorb the largest share of the civil aviation value chain and the growth in air travel should ensure a fair and appropriate long-term return on capital.

11. The public interest requires a continual monitoring and regulation of UK airport operations to promote sustainable growth in UK civil aviation and the adoption of strategies that best serve the wider UK economy. In this respect, while the Society would argue strongly that Heathrow be developed, as the "Jewel in the Crown" of UK airports, further expansion of Stansted, including a second runway, is unnecessary.

12. As much as the UK and London might benefit from a green field approach to airport provision in the South East (proposals for a major facility to the east of London date from 1944, if not earlier), this is neither practical politics nor economically sustainable. Airport strategy for the next decade will have to cope with geographic realities and the consequences of past failures to formulate and implement integrated transport policies. Resources should be focused on improving Heathrow, and floating it as a separately owned company would better allow development and improvement. This would also allow a more transparent approach to investment in the other BAA-owned London airports, as well as ensuring that the interests of Scotland are not neglected as a consequence of dealing with the demands of Heathrow.

Memorandum from Greenpeace UK (BAA 07)

INTRODUCTION

1. Any discussion on the future of BAA plc must be viewed within the context of climate change. This submission sets out the unique challenges facing the aviation sector, and recommends that the development of the company is tempered by these realities.

1.1 Specifically this means:

- No increase in capacity at BAA's (or any successor's) existing airports. This means no new runways or changes to alternation patterns.
- Work within the EU framework policies to allow full auctioning of all slots at BAA's airports, with extra revenues diverted into low-carbon transport alternatives.
- Given the relatively slow progress on technological changes reducing climate impact of aviation, any business model for BAA (or successor) based on major growth in aviation is incompatible with climate protection. Climate change is the biggest threat facing humanity, greater even than terrorism.

1.2 The threat of catastrophic climate change is immediate and real. As detailed in the Stern Review,³ the imperative of addressing the issue now will be cheaper in the long run than leaving it till later. It is widely accepted that that the UK must cut greenhouse gas emissions by 80% by 2050⁴ if we are play our part in global efforts to minimise temperature increases. The unconstrained growth in aviation will make it all but impossible for the UK to meet these targets.

1.3 The Government's policy solution is to see aviation included in the EU Emissions Trading Scheme (EU ETS), arguing this will deliver the CO₂ cuts we need. However, recent research from the Tyndall Centre⁵ shows this proposition to be false. Even if aviation grows at a rate lower than we see today, it could be using up to 100% of the UK's carbon budget by 2050. However, the Department for Transport still predicts⁶ significant growth in aviation and is only relying on emissions trading as the solution. This is a mistake.

1.4 Of course, BAA is not solely responsible for aviation emissions. The airlines clearly play a critical role in developing solutions, as does NATS. However, BAA is the UK's leading airport operator and its development is intrinsically linked with policies on aviation growth.

1.5 Greenpeace believes aviation growth must be constrained, or else the UK will be unable to meet its emission reduction targets.

NO INCREASE IN CAPACITY AT BAA'S EXISTING AIRPORTS

2. Given our position that aviation needs to dramatically reduce its CO₂ emissions, it is essential we do not start by building even more capacity for even more flights. Increasing capacity accepts that continued growth is inevitable and cannot be stopped; whereas constraining capacity will have the very effect of ensuring growth will not be exponential.

2.1 Constraining growth is the only option as there are very few low-carbon solutions on the horizon that will help aviation reduce its impact; this especially true when you consider the lifespan of aircraft being built today. As the public understand the threat of climate change, it is clear they will support a moratorium on new runways. Latest research shows that 70% of the British population are opposed to building bigger airports.⁷

2.2 Proponents of increasing capacity argue that unless we continue to provide unfettered access to the skies, passengers will simply move elsewhere. Aviation is a global issue and every country must reduce its emissions. Simply saying the environmental pollution will originate from overseas rather than the UK is no reason to continue. It is, in fact, an argument for increasing pressure on our European partners to change their policies on aviation expansion. The effect on the UK economy of aviation is also far from clear. There is, for example, a £17 billion annual tourism deficit in the UK,⁸ caused in part by net out-flows of passengers from UK airports.⁹

2.3 A Government strategy to constrain growth at BAA's airports needs to be framed alongside a clear policy to increase availability of suitable short-haul alternatives. A recent study by HACAN¹⁰ estimated that 25% of flights from Heathrow were to destinations less than 500km away and already well served by train. These links must be improved.

³ Stern Review on the Economics of Climate Change, HM Treasury, 2006.

⁴ High Stakes: How large and fast will cuts in greenhouse gas emissions need to be to have a high chance of avoiding dangerous climate change, IPPR, 2006.

⁵ Growth scenarios for EU and UK aviation: contradictions with climate policy, Tyndall Centre, 2006.

⁶ Towards a Sustainable Transport System, Department for Transport, 2007.

⁷ IPSOS MORI, October, 2007.

⁸ UK tourism deficit hits £17 billion, <http://business.guardian.co.uk/story/0,,1677165,00.html>, 2006.

⁹ Cairns *et al*, Predict and Decide: Aviation, Climate Change and UK Policy, Oxford Environmental Change Institute, 2006 p 5.

¹⁰ HACAN, Short-Haul Flights: Clogging up Heathrow's Runways, 2006.

FULL AUCTIONING OF SLOTS AT BAA'S AIRPORTS

3. The current European framework for apportioning slots at airports does not take into account the need for environmental efficiencies. The EU requirement that a slot is used 80% of the time if it is to be secured going forward (grandfathering) means airlines are basically encouraged to fly empty planes in order to keep their slots.

3.1 We believe there should be full auctioning of slots. This will ensure airlines only fly planes that are economically worthwhile for that journey. We understand that this will require Government intervention at an EU level. Potentially this means BAA could dramatically increase their revenues from airlines.

3.2 However, should full slot auctioning become a reality, it is important the extra money is directed at low-carbon alternatives. The money should not become a windfall payment for BAA.

November 2007

Memorandum from the Association of British Insurers (BAA 08)

INTRODUCTION

The Association of British Insurers (ABI) represents the collective interests of the UK's insurance industry. The ABI speaks out on issues of common interest; helps to inform and participate in debates on public policy issues; and also acts as an advocate for high standards of customer service in the insurance industry.

Our evidence is confined to the issues that arise in financing companies which operate in the regulated utilities sector, such as BAA, in which a number of ABI member companies are investors.

THE UTILITIES SECTOR

The characteristics of utilities—a large capital requirement and relatively predictable cashflows—can be attractive to institutional investors, such as insurers, who have long-term liabilities.

Unless it is decided that such companies should be financed entirely through the public purse, we expect a continuation of the current pattern of financing through Public Private Partnerships, Private Finance Initiatives, publicly-listed commercial enterprises and special purpose vehicle entities.

For the utilities, a key objective is to secure a low cost of capital over a prolonged period. This is often achieved through borrowing from the debt market on a secured basis.

In order for utilities to raise such long-term finance, investors must be in a position to assess the risks to which their lending may be subject, including risks arising from public policy and regulatory change.

BAA

In the case of BAA, investors have been closely watching the refinancing plans following the recent changes of company ownership.

The company has advised the markets that such plans are unlikely to be finalised until its regulatory settlement is published by the CAA in March 2008. It seems likely that the Competition Commission inquiry into the ownership and operation by BAA of seven airports in England and Scotland, scheduled for the second half of 2008, will also have an impact.

ABI members, as major institutional investors, will follow these developments closely and anticipate detailed consultations with the company as it develops its refinancing plans.

Member companies' enthusiasm to participate in the refinancing of BAA will depend on the assets dedicated to special purpose vehicles, the visibility and certainty of the forward cashflows and the protections afforded to lenders within the refinancing arrangements.

Lack of clarity of any of these aspects will affect the risk-adjusted reward that investors will require for lending to BAA.

The ABI will be monitoring and feeding into all public debate on these issues and would welcome the opportunity to provide further information to the Transport Select Committee as it carries out its inquiry.

November 2007

Memorandum from the Public and Commercial Services Union (BAA 09)

INTRODUCTION

1. The Public and Commercial Services Union (PCS) represents more than 315,000 workers predominately in the Civil Service but also increasingly in the private sector, particularly where those jobs were once in the public sector. It represents around 2,000 workers in the aviation industry working for the National Air Traffic Service (NATS) and Civil Aviation Authority (CAA) as well as BAA.

2. PCS represents around 500 staff working for BAA broadly in pay bands 3–7 which includes Terminal Control, Flow Control, Security Supervisors, Information and a range of other duties both landside and airside, and support directly the service provided to passengers using the airport and its facilities. PCS also has sole recognition for staff working at the BAA Business Support Centre in Glasgow.

3. We welcome the House of Commons Transport Committee inquiry into the future of BAA and can provide further oral evidence if required.

SUMMARY

4. PCS strongly opposes the break-up of BAA as we do not believe it is in the interests of its staff or passengers.

5. PCS believes in a defragmented aviation industry.

6. PCS recognises the significant impact the industry has on the wider UK economy, together with the thousands of jobs associated directly and indirectly with major airports.

7. PCS recognises the contribution that the industry must make to mitigate against the effects of the industry on climate change and global warming.

8. PCS believes that an airport's customers are the airlines. We are concerned that competing priorities may compromise the provision of a consistent service to passengers.

9. PCS is concerned at the impact that “change” and “simplification” will have on the ability of BAA airports to meet the challenge of significant events such as heightened security due to specific threats.

WHO IS THE CUSTOMER?

10. Within the wider debate about the services provided by the aviation industry there is often a lack of clarity as to who should be defined as “the customer”; is it the passenger or the airline?

11. A passenger's experience within an airport is affected by both the service provided by the airport, but also that provided by the airline. Where these two service providers' approaches conflict, the passengers' experience will be seriously diminished. For example, the decision by some low-cost airlines to encourage passengers to take “hand-luggage” rather than “hold-baggage” directly impacts on the services provided by a busy airport which is required to ensure high-levels of security. Some airlines charge a premium for hold baggage to discourage its use. Fast turnaround times—designed by airlines to increase their profitability—impacts on the numbers of passengers within terminals, how they move around terminals, and their experience within the airport. It also impacts directly on the ability of the airline to meet its published timetables, leading to delays and cancellations, and further adding to the misery at the airport—a misery often directed at airport staff.

12. The interests of the airline and of the airport are not automatically in competition but can, on occasion, impact on the passengers' experience of travel. The desire of the airlines to promote the travel experience can be reduced by the desire to increase profits and reduce costs.

13. PCS believes that for absolute clarity when talking about an airport's customer this refers to the airlines. It should also be recognised that both the airport and the airline have a common responsibility to the passenger.

AIRPORTS ACROSS THE COUNTY

14. BAA airports play an important role in UK transport infrastructure. London Heathrow is the world's busiest airport and is a major gateway to Europe for the transfer passenger. It also competes directly, in this regard, with Amsterdam, Paris and Frankfurt rather than other UK airports. Heathrow's importance to the UK's economy is huge—it employs over 100,000 workers in and around the west London area.

15. London Gatwick is the busiest single runway airport in the world and London Stansted is a major airport for low-cost airlines making international travel opportunities possible for millions more people than would otherwise be the case. It is worth noting that the UK has more low-cost airlines and flights than anywhere else in the world, adding testimony to the argument that the major UK airports offer good value for money.

16. Scotland's airports within BAA ownership provide international flights from Glasgow and Edinburgh, as well as a significant service to the UK's oil industry served by the many helicopter flights from Aberdeen alongside its regional services.

17. The success of BAA airports contributes to the prosperity of the regions by attracting business and industry to the areas they serve. It is in the interest of their staff that BAA is successful (so long as it invests the fruits of that success in its workforce) and despite the issues of concern highlighted below, it remains PCS policy that BAA airports should remain together, both in the interests of staff and also the industry as a whole.

CLIMATE CHANGE

18. BAA, along with all parts of the aviation industry, must also take seriously its role in addressing the effects of climate change on the environment. The projected growth in air travel will increase the levels of CO₂ emissions associated with the aviation industry well above the current levels of 6%. Across the developing world there is the potential for huge growth in air travel and this is most reflected in the huge projected growth in China and India. The aviation industry can meet that challenge but will be less able to do so if it is itself fragmented. Decisions about extra runway capacity or an additional terminal should be made not just for the benefit of a single airport operator but "in the round" in terms of region, passengers etc. Aircraft manufacturers must develop the technology, airlines must buy new aircraft, airports must accommodate them; air traffic must provide more direct routes to shorten flights, and so on. The industry already faces several obstacles in reducing its impact on the environment and does not need more.

19. Reducing our dependency on fossil fuels is not, however, limited to the aviation industry. The need to have cleaner airplanes, more efficient routing of aircraft in the air and continuous descent through even more efficient air traffic management, as well as a more integrated transport system and better and more efficient access to airports and other transport hubs, is crucial. The airline manufacturers have a huge responsibility to meet this challenge both in terms of emissions and noise.

GROWTH IN CURRENT CAPACITY

20. The investment from a large organisation with the technical expertise of BAA is vital in order to keep pace with the demand for extra capacity expected by the airlines and the global travel industry. To reduce the capability to invest in the infrastructure in a position to respond to change it is important to maintain a structure that can respond to the demands of the industry. Fragmentation of this structure would lead to delay in response and political conflict between the various sectors of the industry and different standards applied across the industry.

21. PCS believes that an integrated transport system is crucial and that further fragmentation will not assist this already troubled process. There are longstanding debates raging about the prospect of airport expansion with the question of additional runways at Gatwick and Stansted or a third runway at Heathrow proving highly controversial. A new direct rail link to Edinburgh airport was abandoned in September following many millions of pounds of investment in its feasibility. These decisions and their potential impact on the UK economy and on jobs cannot be left to a fragmented industry with competing objectives that do not align.

22. Projected growth does impact on the wider economy and failure to meet those targets will adversely affect both businesses and jobs. PCS represents members working for NATS, the UK's air navigation service provider, which serves BAA's airports as well as many other airports in the UK. Year on year growth targets of 3% are factored into both investment strategies and future working practices and technologies. Such growth figures cannot be sustained if there is insufficient runway and airport capacity to cope. However, restrictions imposed by capacity will not see a reduction in growth but will see the UK losing out on the commensurate investment and job opportunities to its real competitors elsewhere in Europe.

BAA AS EMPLOYER

23. PCS is also concerned with BAA as an employer both in terms of the service it provides as well as the terms and conditions of service of members. The "change programme" introduced by BAA three years ago and implemented in all its airports has had a direct impact on the jobs of individual workers and has seen many leave through voluntary redundancy packages. In some cases these workers have immediately rejoined BAA to ensure the continued operational integrity of the service it provides. PCS is concerned that those who have left employment have taken with them significant expertise and knowledge of the company and the industry. No operator could be expected to be able to meet the challenge posed by the increased security measures following the August 2006 security alert, but many of our members and members of other unions at BAA, worked extremely hard to rise to that challenge. PCS believe that BAA would be in an even worse position to meet a similar security situation following further redundancies.

24. “Simplification” is, in effect, “change II” and is likely to see a further 1,000 jobs lost across BAA. PCS will work with BAA through the consultation processes and seek to protect our members and avoid compulsory redundancies. However, those members who will remain are disillusioned by another attempt to weaken the organisation and increase the pressure that they experience on a day to day basis.

25. Pressure from the regulator is designed to drive efficiencies and to ensure there are market forces applied to the industry and London’s major airports. This has seen a challenging charging regime for the forthcoming period and provides the background for the changes outlined. PCS recognises the need for the regulator to ensure there is value for money but is concerned that it fails to appreciate some of the wider challenges faced by BAA in terms of balancing the needs of its customer with that of the passenger. The regulator seems far more beholden to the airlines than it is to the paying passenger whose voice is used by the airlines but not really heard in respect of an integrated industry.

26. PCS, along with other unions, is in dispute with BAA over its decision to close the pension scheme to new members with effect from 1 December 2007. This decision is not a consequence of the viability of the scheme but a purely financial decision taken without consultation and negotiation. This decision will be fought both politically and industrially and any industrial action will impact directly on airport services.

27. PCS’s concerns regarding BAA are industrial. We seek to engage with the employer at all levels to resolve these disagreements constructively. We do not believe that this situation would be improved by a broken up BAA, nor do we believe that this is helped by impositions from a regulator that seems to fail to recognise the impact its decisions have on the workers and the passengers.

November 2007

Memorandum from the Department for Transport (BAA 10)

INTRODUCTION

1. Air travel makes a substantial contribution to the UK economy and individuals. As BAA is one of the UK’s major airport infrastructure providers in this important and growing industry, the Secretary of State for Transport welcomes the opportunity to provide evidence to the Transport Select Committee’s inquiry.

2. The following evidence addresses the particular areas in which we understand the Committee to be interested:

- The context of Government policy and economic regulation of the industry.
- The consequences of Ferrovial’s takeover of BAA.
- The Competition Commission’s report on the price caps for Heathrow and Gatwick Airports, published October 2007 and its implications for BAA debt refinancing.
- Passenger experience—the findings of the Competition Commission’s inquiry into the services provided at Gatwick and Heathrow and the Government’s desire to improve end to end journeys.
- Surface access to London Heathrow.
- The Competition Commission’s inquiry into the supply of airport services by BAA and its possible outcomes.

CONTEXT

3. *The Future of Air Transport White Paper*, 2003, set out the Government’s sustainable long term strategy for the development of air travel out to 2030. Commitment to this strategy was re-affirmed in 2006 in *The Future of Air Transport Progress Report*. The strategy balances our growing aspirations to travel and the needs of our economy, with the need to protect our environment.

4. The Government remains committed to this strategy. It rejects a “predict and provide” approach and instead proposes a comprehensive strategy that:

- Commits Government to ensuring that aviation reflects the full costs of its climate change emissions, which will influence the amount of traffic growth that will occur. This is the same approach Sir Nicholas Stern¹¹ recommended right across our economy;

¹¹ Stern Review on the Economics of Climate Change, 2006.

- Puts in place tough local environmental conditions for our most environmentally sensitive airport, London Heathrow. Further expansion in flights would not be allowed unless limits on noise and air quality could be met;
- Recognises that aviation brings real benefits to the lives of ordinary people and to business. It connects people and places in ways that many people value highly and is also critical for a successful economy. Since publication of *The Future of Air Transport White Paper* in 2003, the number of passengers using our airports has risen by 14%;¹²
- Rejects proposals for new capacity at several airports and at new Greenfield locations, and instead initially promotes making better use of existing airport capacity. The strategy supports the development of regional airports mostly within existing capacity (in the early years), as well as the construction of a second runway at Stansted and a third at Heathrow if environmental conditions could be met. It also supports measures to make better use of existing runways at those airports.

5. *The Future of Air Transport Progress Report*¹³ re-affirmed that additional runway capacity in the South East is central to Government policy:

“... while making best use of existing runways in the South East and supporting increased routes and services in other regions could reduce pressure on the major South East airports, this would fall short of a sustainable long-term solution if trends continued. The Government therefore supported the development of two new runways in the South East: at Stansted and at Heathrow if environmental conditions could be met”.

6. It is important to recognise however that unlike transport infrastructure such as the strategic road network for example, in the UK, our airport infrastructure is, in most cases, provided and funded wholly by the private sector. At airports therefore, decisions on the provision, enhancement and expansion of airport capacity are therefore based entirely on commercial considerations and are not within the remit of Government.

7. For the most part, airports compete in a free and open market. Just four are subject to economic regulation as they have been designated by the Secretary of State for the purposes of price control. These are Gatwick, Heathrow, Stansted and Manchester, the first three of which are owned by BAA.

8. At these airports, a cap is placed on the maximum revenues per passenger that they are permitted to charge users for their services. The economic regulation of those airports is carried out by the independent industry regulator—the Civil Aviation Authority—in line with its statutory duties as laid out in the Airports Act 1986 and the Civil Aviation Act 1982. The level of the cap is set independent of Government, and is irrespective of ownership.

9. The decision to designate an airport is made on the basis of established criteria. New criteria were announced by the Secretary of State for Transport in May 2007 following a public consultation process. Government has also consulted on the designated status of Manchester and Stansted airports. The consultation period closed on 17 October and the Secretary of State will announce her decision soon.

THE CONSEQUENCES OF FERROVIAL'S OWNERSHIP OF BAA

10. As we made clear in our evidence to the Competition Commission's inquiry into the supply of airport services in the UK by BAA, our primary concern in relation to the ownership of UK airports is the ability and commitment of airport owners to make the necessary investment to provide the airport capacity supported in the Future of Air Transport White Paper (ATWP).

11. We do not believe that there are any implications for the industry or the regulatory framework specifically relating to foreign ownership of its airports (assuming they meet the security requirements applicable to all UK airport operators). We do however have an interest in the extent to which any airport owners are led by competent management personnel and are subject to the same investment incentives as UK companies.

12. In the particular case of BAA, we have an interest in the extent to which the financial structure (its gearing), impacts on BAA's ability to raise the finance required to deliver the additional airport capacity we support in the South East. We are monitoring the situation closely, engaging regularly with both BAA and regulators.

¹² CAA Airport Statistics (2005), www.caa.co.uk

¹³ Future of Air Transport Progress Report, DfT, December 2006 (page 42).

13. At acquisition, BAA's new owners, Airports Development and Investment Limited (ADI—the consortium including Ferrovial that was formed to acquire BAA) stated their commitment to delivering the airport capacity needed and we have had no indications from BAA that this commitment has wavered.

THE COMPETITION COMMISSION'S REPORT ON THE PRICE CONTROL OF GATWICK AND HEATHROW AIRPORTS

14. The recently published Competition Commission (CC) report on the price controls for Gatwick and Heathrow followed the reference of these airports to the CC by the CAA, as part of the statutory process of economic regulation.

15. The process will continue with publication by the CAA of their firm proposals in November 2007, followed by a period of consultation and a final CAA decision in early 2008.

16. The CC report recommended the price cap at Heathrow should be £10.19 per passenger from 2008 rising at 7.5% above inflation each year, with an underlying real rate of return on capital of 6.2%; at Gatwick, the recommended revenue cap was £5.50 per passenger from 2008 rising at 0.5% below inflation each year, with an underlying rate of return on capital of 6.5%.

17. BAA issued a statement in response to the CC report which stated that “implementation of the refinancing has been negatively affected, both in terms of timing and practicability”.¹⁴

18. A further BAA statement was issued reassuring creditors that they remain in compliance with the financial and other covenants of their bonds, and confirming their commitment to a refinancing. “BAA will, over the coming months, be working with its advisers and other key transaction parties including the rating agencies to continue to design a refinancing plan, although it may well not be able to finalise any such plan until the regulatory settlement is published by the CAA next March”.¹⁵

19. The rating agency Moody's noted that “the delay in concluding a Ring-Fenced Financing has created greater uncertainty of execution. This is because debt markets may become less amenable to a Ring-Fenced Financing in the light of the then approaching time for the publication of the CC's review of the ownership of BAA's airports. Furthermore . . . a material period of delay beyond BAA's current timetable may pressure BAA's liquidity position in the absence of the sourcing of additional committed facilities”.¹⁶

20. The key interest of Government in this regard is the potential impact of a failure to refinance BAA's debt on the ability of the company to raise the finance required to deliver the investment set out in the Government's White Paper. We are monitoring progress closely.

PASSENGER EXPERIENCE—THE FINDINGS OF THE COMPETITION COMMISSION AT GATWICK AND HEATHROW AND THE GOVERNMENT'S DESIRE TO IMPROVE END TO END JOURNEYS

21. The Government recognises the importance of the passenger experience throughout the whole journey. It therefore supports efforts made by any airport owner, or indeed airlines, to improve the quality of service offered.

22. As part of the Competition Commission reference of the two BAA airports—Gatwick and Heathrow—it found that both airports had acted against the public interest in some areas of service provision, such as management of the maximum length of security queues.

23. Mechanisms already exist to improve passenger experience at those airports. As part of its economic regulation of airport charges, the Civil Aviation Authority (CAA) put in place in 2003 a regime of service quality targets for BAA with financial penalties if these targets were not met on a month by month basis. The CC has recommended strengthening and extending this scheme.

24. In addition, the CAA through its price controls encourages timely investment in facilities, many of which are designed to improve conditions for passengers. This has provided sufficient incentive for BAA to bring forward investment in Terminal 5, which is scheduled to open in March 2008 as planned, and which should significantly enhance passenger experience across the airport. Looking forward, the CC also recommended that future investment at Heathrow be further incentivised through greater financial penalties for later delivery of projects.

25. On 30 October, the Government published its response to the recommendations made in the Eddington study. The paper *Towards a sustainable transport system—supporting economic growth in a low carbon world* reinforces the important role that international gateways play in the UK economy.

¹⁴ ADI and BAA announcement in relation to the publication of the Competition Commission Report to the CAA around price controls at Heathrow and Gatwick press release, dated October 2007.

¹⁵ ADIL and BAA clarification for creditor press release, dated October 2007.

¹⁶ Moody's maintains BAA ratings at BAA2, review for downgrade press release, dated October 2007.

26. We await with interest the CAA's final proposals on the price caps at Gatwick and Heathrow and their impact on the passenger experience.

SURFACE ACCESS TO HEATHROW AIRPORT

27. The capacity expansion at Heathrow airport supported in our White Paper is likely to have implications for the surface access links. A provisional review of surface access to Heathrow airport has been carried out as part of the programme of work for the forthcoming Heathrow consultation into how capacity could be increased at the airport.

28. This work has looked at how Heathrow could benefit from enhancements to rail services such as Crossrail, Airtrack and the Piccadilly line; from improved bus and coach services; and, from park and ride services.

29. As described above, following consultation, any decision whether to proceed with the provision of additional capacity at the airport is a matter for BAA as the independent commercial entity. It would therefore be for them, and not Government, to develop a detailed surface access strategy as part of any planning application.

THE COMPETITION COMMISSION'S INQUIRY INTO THE SUPPLY OF AIRPORT SERVICES BY BAA AND ITS POSSIBLE OUTCOMES

30. The Competition Commission is currently undertaking an inquiry into the supply of airport services by BAA in the UK. This follows the reference made by the Office of Fair Trading on 29 March 2007, under S131 of the Enterprise Act (2002).

31. The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market or markets in which airport services are supplied by BAA prevents, restricts or distorts competition with the supply of airport services in the UK. With the inquiry not due to end until March 2009, it is still relatively early in the process.

32. The Competition Commission is the UK's independent competition authority and is therefore carrying out this investigation independent of Government, industry or other parties.

33. As set out in our evidence to the Competition Commission, we recognise the vital role that competition—where it is practical—plays in both protecting the consumer and ensuring the continued development of an efficient and sustainable UK aviation industry. The role of the DfT in this investigation is, like other parties, to respond to requests for evidence as required. We have no role in determining the Competition Commission's final views but will of course have a keen interest in those findings and the extent to which they may have implications for the delivery of the Air Transport White Paper policies and the economic regulatory framework.

CONCLUSION

34. This paper has set out that in relation to BAA's ownership of some of UK's airports:

- The primary interest of Government is the extent to which the additional capacity supported in the Future of Air Transport White Paper at the two airports owned by BAA in the South East, is deliverable.
- Airports are mostly owned and operated by independent commercial entities who make their own investment decisions on capacity provision, enhancement or expansion, based on commercial considerations.
- The Secretary of State for Transport designates airports for price control in line with specific criteria, but the level of price cap set at each designated airport is a matter for the independent industry regulator—the Civil Aviation Authority.
- The Government recognises the importance of the passenger experience throughout the whole journey. It therefore supports efforts made by any airport owner, or indeed airlines; and the provision of incentives through the regulatory system, to improve the quality of service offered.

Memorandum from the London Borough of Hounslow (BAA 11)

1. INTRODUCTION

1.1 The Select Committee extended an invitation to interested parties to submit written evidence to the inquiry into the future of BAA. The London Borough of Hounslow—“Hounslow Council”—would be willing to supplement this written submission through participation in a future oral evidence session if the committee believe that would be beneficial to the inquiry.

1.2 Hounslow Council welcomes the opportunity to submit a summary of views on the role, function and Future of BAA. Hounslow Council recognise that there is increasing public interest in aviation issues, and in particular, the aviation related environmental impacts. Hounslow Council is a direct neighbour of the BAA Heathrow Airport complex. As such the Council believes the views it puts forward warrant consideration by members of the Transport Select Committee.

1.3 Hounslow Council believe there should be a clearer, enhanced responsibility placed upon BAA by the Government and relevant regulators to deliver, and maintain, proper and adequate mitigation measures to counter the detrimental impacts caused by operations to, from and around the BAA Heathrow Airport complex. In particular, Hounslow Council believe that BAA must be required, by legislation to ensure that educational facilities in the communities surrounding the Heathrow Airport Complex—which are compromised by aviation operations—are made “fit for purpose”.

An obligation to provide adequate protection to children, teachers and staff in nurseries, schools and colleges in communities surrounding its airports must be examined in discussions and considerations about the Future of BAA.

2. CONTEXT

2.1 The Borough of Hounslow is the gateway to the capital, rich in cultural heritage and vibrant communities. The ninth largest of London’s 32 boroughs, covering 22 sq miles from Chiswick in the east, through Isleworth and Brentford, past Hounslow Central to Bedfont, Feltham and Cranford in the west, the environment of Hounslow is dominated by its close proximity to BAA’s Heathrow Airport.

2.2 Hounslow Council recognises the contribution that BAA has made to the national and regional economy. With around 11,000 borough residents directly employed at Heathrow airport and many others in associated employment, the value of Heathrow airport to the local economic environment is appreciated. Heathrow airport has been a catalyst to much inward investment including the locating of GlaxoSmithKline’s European Headquarters within the borough. Hounslow Council has had ongoing contact and a relationship with Heathrow airport and its operators, BAA, over the years.

2.3 However while BAA Heathrow is a relatively successful commercial entity, it must be acknowledged that there is a cost behind that success. In the year 2006, approximately 470,000 flights either landed at or departed from Heathrow airport—carrying approximately 68 million passengers. Even the most ardent supporter of aviation would be forced to concede that such a large scale operation must impact on the environment surrounding the airport complex, bring pressures upon the infrastructure of nearby communities and affect the quality of life of local residents.

2.4 The main environmental impacts, social pressures and health effects affecting the 220,000 + residents in the borough of Hounslow relate to noise and air quality, surface access, land pressures and transport congestion. All of these aspects create “community blight” and are issues that Hounslow Council has highlighted and sought dialogue with BAA on over several years.

2.5 Hounslow Council believe that the BAA Heathrow airport complex has reached the limit of sustainable development and that BAA forward plans for future expansion of the airport be that in the form of a third runway, additional terminals or intensified runway use, are not fair nor acceptable. Hounslow Council has a clearly defined aviation policy that is based on the principles of sustainable development and the “polluter pays” principle aimed specifically at Heathrow airport. In summary the objectives are that:

- Mitigation is provided to counterbalance the current impact of Heathrow airport operations.
- Further development that leads to an intensification of the operational use of Heathrow Airport, for example through the introduction of mixed mode operation, be opposed.

3. BAA; A CHALLENGING NEIGHBOUR

The challenge of Noise

3.1 Noise pollution caused by aviation operations at BAA Heathrow remains principal concern of the residents of the borough of Hounslow. Currently, aircraft fly in over the borough every 90 seconds during peak time. While that is a high level of disruption it is the night flights and the early morning arrivals from the pacific-rim that cause a disproportional level of disturbance to residents.

3.2 The 2003 DfT Aviation White Paper¹ pledged that expansion would only go ahead if it resulted in “no net increase” to the size of the area around Heathrow affected by 57 decibels of aircraft noise—the level deemed to mark “the onset of significant community annoyance”. However the Government’s own ANASE study² suggests that significant annoyance starts at around 50 decibels, which means that all of Hounslow’s 215,000+ residents (and around 2.5 million people across West London in total) are affected by aircraft noise.

3.3 The Aviation White Paper suggested that the Government would bear down on noise especially at night and that it recognises that noise from aircraft operations at night is widely regarded as the least acceptable aspect of aircraft operations. But at the same time suggests that an increase in the number of night movements is appropriate. WHO recommend a noise level for a bedroom is 30dB(A).

The challenge faced by School Children

3.4 Successive studies have shown that aircraft noise affects school children’s ability to learn. The Select Committee may be aware of the previous study, Road Traffic & Aircraft Noise & Children’s Cognition and Health (RANCH)³ by Queen Mary College and partners which was reported in the Lancet.⁴ This reported that children’s educational development was being affected by exposure to aircraft noise. The findings of the Lancet study reflect those of similar studies undertaken in the UK and elsewhere in recent years. The teachers and pupils in schools throughout Hounslow can testify that noise is a serious problem in their classrooms and play areas.

3.5 More than 35,000 children attend schools in Hounslow and many are educated in noise environments that do not meet relevant DFES standards for noise and ventilation.⁵ Hounslow Council has pursued the introduction of adequate noise insulation and ventilation schemes for many local schools where school children are affected by aviation noise with both BAA and the Government. Hounslow Council acknowledge there are voluntary BAA insulation schemes on offer to local schools, but as BAA is well aware, the Council remains disappointed about the level of funding allocations and about the initial reluctance to provide associated ventilation systems.

3.6 Hounslow Council has previously highlighted to BAA that in some instances aircraft noise disturbance is so intensive, that certain schools will have to be rebuilt. BAA previously rejected a council-backed scheme to protect all schools from aircraft noise in the summer of 2005. Hounslow Council has subsequently undertaken extensive research into the cost of bringing its 79 schools in line with DFES standards. According to this research, the cost of meeting the noise and ventilation standards for schools laid down by the DFES in the borough of Hounslow alone is £103.6m (2005 figure). Within the current scheme BAA has allocated £5million per year over five years.

The challenge on Air Quality & Transport

3.7 West London already has some of the poorest air quality in the UK. The 2003 Air Transport consultation had made clear that a third runway at Heathrow would lead to an additional 21,000 people being exposed to nitrogen dioxide levels which exceeded EU limits. Mitigation measures to address this will require major effort and significant resources. The Air Transport White Paper, paragraph 3.31 stated that achieving EU air-quality limits will require a “combination of measures” to be undertaken by local authorities, transport bodies and airports, limiting road traffic emissions associated with passengers and employees. This must include the increased provision and use of public transport.

3.8 Much of the air quality in the borough of Hounslow is in breach of the required standard.⁶ This is related to the operations at and around the BAA Heathrow airport complex, including associated surface transportation. The cost of attempting to manage, let alone minimise, the deteriorating air quality environment is beyond the scope of a local authority. In the borough of Hounslow local road and public transport networks are already at over-capacity. Capital investment is required to improve public transport links. The transportation of passengers and staff using the new BAA Terminal Five from March 2008 will severely exacerbate the problem. Hounslow Council is keen to learn what contact and discussions BAA has had with Ministers and their officials on adequately developing and financing the local transport infrastructure at and around the BAA Heathrow Airport complex.

4. THE FUTURE WITH BAA

4.1 This submission is being drafted as Hounslow Council and many others await the publication of the long delayed DfT consultation on the future development of BAA Heathrow Airport. It is expected that the consultation will include:

- Proposals for the abolition of the Cranford agreement (meaning no departures to the east on the northern runway over the Cranford area, emergencies excepted).
- The introduction of mixed mode (aircraft landing and departing on the same runways at the same time) and the associated abolition of runway alternation.
- Proposals for a third runway.

— Proposals for a sixth terminal.

4.2 Expansion on this scale will see Heathrow's capacity double in a decade. Communities like Hounslow will have to endure an extra 6,000 planes a week flying overhead at a rate of one every 30 seconds at peak times. Runway alternation is probably the most valued mitigating factor experienced by the residents of the borough. It is quite common for people to plan their days and weeks around the alternation pattern particularly when activities are being held outside.

4.3 Residents advise Hounslow Council that the abolition of runway alternation is unthinkable. In relation to the schools in Hounslow loss of alternation will mean that there is no time that is free from aircraft noise. Learning outside will no longer be a practical option. With the addition of a third runway, new areas will be overflowed all the time particularly Heston and Norwood green, (and others).

4.4 The 2003 DfT Aviation White Paper quoted the net benefits of expanding the BAA Heathrow airport complex as at £6 billion. However, this financial gain to the UK economy must be balanced against the Environmental dis-benefit. The Government has committed to the achievement of the air quality limit value for nitrogen dioxide and state that the noise level at the 57dBA contour must remain at 127 square kilometres. It has been forecast that a third runway will bring an extra 21,000 jobs to the area with nearly 50,000 during the construction phase. Given the skills and labour shortage in the area it is thought that many people would have to travel considerable distances to fill this need.

4.5 Hounslow Council is not convinced that expansion of the airport can be achieved within the Government specified environmental limits without making unreasonable assumptions. For example the air quality standard for nitrogen dioxide is not being achieved at present and Terminal 5 has yet to open. Decisions will be made on the basis of predictive computer modelling which will have a modicum of the uncertainty (although it is recognised that the £1.87 million spent on the project to sustainable development of Heathrow process will improve model accuracy⁷). If errors are made and environmental limits are exceeded it is the Hounslow community that will bear the brunt, yet again.

4.6 Without prejudice to the Council's position on BAA Heathrow's expansion, Hounslow Council seek:

- Noise insulation for all domestic premises that are affected by aircraft noise to WHO levels.
- Noise insulation for the schools so that they achieve the required standard.
- Hypothecation of air passenger duty (or whatever supersedes this) towards mitigation of the environmental effects.
- A redesigning of the surface transport system so that workers and passengers can get to the airport at any time by suitable and sustainable means.
- Extension of the aircraft vortex protection scheme to account for any affects that a new aircraft fleet may bring.

5. CONCLUSION

5.1 An examination of the impacts caused by aviation operations to, from and around the BAA Heathrow Airport complex often becomes highly focused on the exploration of possible mitigating measures. Such measures are often provided as a condition of a development within the normal planning process. In the case of Hounslow Council and the neighbouring BAA Heathrow Airport complex. There are two problems with this:

- Hounslow is not the planning authority for the airport and therefore its ability to negotiate mitigation on matters such as for example, a change in the routing of a taxiway is greatly limited.
- Heathrow's growth is incremental. In 1994 there were 424,600 air transport movements increasing to 460,000 in 2004. There is no formal mechanism for obtaining mitigation for this growth.

5.2 Subscribing to the "polluter pays principle" Hounslow Council have made numerous direct approaches to BAA on a variety of mitigation issues. However no satisfactory outcome has ever been agreed. BAA has previously suggested that Hounslow Council enter into a "Compact"—however such agreements are predicated on airport expansion. Hounslow Council has not ruled out this course of action entirely (with respect to the current situation) but would propose that instead of time intensive negotiations between a local authority and a commercial entity like BAA wrangling on, the Government should look to introduce an environmental charge on the BAA Heathrow airport complex and use the revenue from this to deliver mitigation measures to counter the detrimental impacts caused by operations to, from and around the BAA Heathrow Airport complex.

5.3 Hounslow Council makes this submission to stimulate a positive engagement with members of the Select Committee and hopes that a consensus can be developed on how to address and counter the negative effects of aviation related operations at the BAA Heathrow airport complex. For the future, Hounslow Council look forward with hope to a better relationship with BAA—as everyone wants a good neighbour.

REFERENCES

- ¹ Aviation White Paper “The Future of Air Transport” December 2003, DfT
- ² Attitudes to Noise from Aviation Sources in England (ANASE) November 2007 study <http://www.dft.gov.uk/pgr/aviation/environmentalissues/Anase/>
- ³ <http://www.wolfson.qmul.ac.uk/RANCH—Project/>
- ⁴ Aircraft and road traffic noise and children’s cognition and health: a cross-national study, *www.thelancet.com* Vol. 365 June 4, 2005
- ⁵ BB93 Building Bulletin 93 Acoustic Design Of Schools A Design Guide As revised 20 November 2003 and BB101/ Ventilation of School Buildings July 2006
- ⁶ First Daughter Directive: Council Directive 1999/30/EC 22 April 1999
- ⁷ Answer to Parliamentary Question laid by Justine Greening, Hansard 23 Oct 2007: Column 230W

Memorandum from the Competition Commission (BAA 12)

1. BAA Ltd and/or its airports are currently the subject of three investigations and consultations:

- *A Market Investigation* being carried out by the Competition Commission (the CC) following a reference from the Office of Fair Trading (the OFT).
- *Price Control Determinations* being made by the Civil Aviation Authority (the CAA) following recommendations from the CC.
- A Consultation by the Department for Transport (DfT) on the possible *De-designation of Stansted and Manchester Airports* following advice from the CAA.

Whilst these are all separate inquiries with different objectives and under different legislation, they contain a number of common or interrelated strands or themes.

2. BAA owns seven UK airports: Heathrow, Gatwick, Stansted, and Southampton in England; and Edinburgh, Glasgow and Aberdeen in Scotland. It was acquired in 2006 by a consortium comprised of Grupo Ferrovial, S.A. (Ferrovial) (61.06% of the ordinary shares) and two investment funds (from Canada and Singapore). In the UK, Ferrovial also owns Belfast City Airport which is not the subject of any of the above inquiries etc. Manchester Airport is not owned by BAA or Ferrovial.

3. The following notes summarise some quite complex and lengthy reports etc. Full details are available on the CC’s website (www.competition-commission.gov.uk) and other organisations’ websites.

THE MARKET INVESTIGATION

4. On 29 March 2007 the OFT referred *the supply of airport services by BAA within the UK* for investigation by the CC. The CC is required to report within two years. When making the reference, the OFT said:

“One company, BAA, owns airports through which over 60% of all UK air passengers travelled in 2005. It is a major company, with UK revenues of £2,275 m in 2005–06, and its activities impact on a large number of businesses and consumers. The OFT has concluded it has reasonable grounds to suspect that BAA’s high regional market shares in the South East of England and Lowland Scotland, the system of economic regulation of airports, and capacity constraints combine to prevent, restrict or distort competition.

Airports have benefited from the rapid and ongoing expansion of the airlines, leading to greater economies of scale in certain operations, while posing challenges to expand capacity to meet demand.

In Lowland Scotland, BAA’s ownership of Edinburgh and Glasgow airports limits competition between these two airports. There are high barriers to entry and these airports are not subject to detailed price regulation. There is one independent competitor in this region, Prestwick airport, which seems to have had some positive competitive effect on Glasgow airport. We believe there is room for competition to provide further benefits to air travellers. We consider that joint ownership of Glasgow and Edinburgh airports prevents, restricts or distorts competition.

In the South East of England, BAA’s ownership of Heathrow, Gatwick and Stansted limits competition between airports to promote the delivery of extra capacity in a timely and cost effective manner. The overwhelming bulk of the expansion of capacity set out in the “Future of Air Transport” would take place at BAA owned airports. BAA has made it clear that it will only

deliver this capacity, subject to planning permission and continued Government support, if it is allowed an appropriate settlement at its price regulated airports (Heathrow, Gatwick and Stansted).

None of the major airlines operating out of BAA airports in the South East of England expressed confidence in BAA's current investment plans for the South East of England.

We also have concerns about the impact of the current regulatory framework. In particular, BAA has an incentive to make investments justifying higher charges to airlines, without necessarily expanding capacity ("gold plating"). While the CAA has a role in approving the inclusion of investments within the regulatory asset base, it is also under a duty to promote investment. The appropriate timing and specification of investments are extremely difficult for a regulator to assess.

There is evidence of poor quality of service at BAA airports, particularly those in the South East of England. This low quality appears to go hand in hand with relatively high yields. The combination of low quality and high yields was raised by several respondents during the market study and in the consultation on our proposed reference decision which raises a valid question as to the benefits to consumers of the current situation.

We believe that enhanced competition between airports would create better incentives to ensure that expansion takes place in a timely, cost effective manner focussed clearly on the needs of airlines and the travelling public. It could also deliver lower prices and a higher quality of service."

5. The CC subsequently published an issues statement to help focus its market investigation. The CC said that it was looking carefully at a wide range of issues, many of which were complex and interrelated. Some are essentially short-term but, given the nature of airports, others involve much longer timescales stretching over the next 10 or 15 years.

6. The CC said that it was in particular looking at:

- how common ownership could affect BAA's incentives both to invest in and develop its airports, and operate them;
- how the quantity, specification, quality, location and timeliness of capital expenditure, ranging from capacity to security, might be affected by common ownership; and
- how common ownership might affect incentives to improve operating efficiencies as well as levels of service, including recently, and most notably, security;
- the consequences of the airports' regulatory regime;
- the impact of restrictions on airport development; and
- constraints on capacity in terms of runways, terminals, other facilities, and airspace for planning or other reasons.

7. The CC is continuing to gather and analyse evidence with a view to publishing its provisional findings in the second half of 2008.

PRICE CONTROL DETERMINATIONS

8. Because of their strong market position, four UK airports are "designated" by the DfT so that their aeronautical (including take-off, landing and parking) revenue yields are subject to limits set every five years by the CAA following recommendations from the CC which in turn comments on an original proposal from the CAA. The five yearly reviews are known as "quinquennials" and the current reviews are known as Q5.

9. The CAA has recommended to the DfT that both *Stansted and Manchester* should no longer be price controlled. This de-designation proposal is discussed further below.

10. The CC sent its recommendations to the CAA on the *Heathrow and Gatwick* controls (for the five years from 1 April 2008) on 28 September 2007. It said that it recognised the importance of both Heathrow and Gatwick to the UK economy and hence the need over the next five years for BAA to undertake large capital expenditure programmes at both airports whilst also operating them efficiently and providing enhanced levels of service. The CC believed that its recommendations to the CAA would enable BAA to implement its plans in full for the benefit of airlines and passengers and at a justifiable level of airport charges. The CC also considered they would enable BAA to earn an adequate return for its shareholders and other providers of finance.

11. The CC recommended an increase in the maximum level of airport charges at Heathrow of RPI + 7.5 (that is 7.5% a year above the increase in RPI) and a small reduction below RPI at Gatwick (0.5% below the increase in RPI). (For reference, the indicative ranges put to the CC by the CA were between RPI + 4 and RPI + 8 at Heathrow, and between RPI - 2 and RPI + 2 at Gatwick, but the figures are not easily comparable for a number of reasons.)

12. BAA regarded the CAA's proposals as being unacceptably low, and proposed a much larger increase. Among the proposals from other parties, British Airways had argued for a reduction in charges at both airports, with a formula of RPI - 1.5 at Heathrow and RPI - 4.4 at Gatwick.

13. A main issue in the CC's inquiry was the appropriate cost of capital—over 35% of Heathrow's costs. Indeed, every 0.1% increase in the cost of capital increases aeronautical revenue yields by c.£50m over five years. The CC recommended that airport charges should be based on a real pre-tax rate of return of 6.2% at Heathrow and 6.5% at Gatwick. These figures were close to the top end of the CC's estimated range and took into account both the inherent uncertainties in any such estimates, and the importance of not allowing a rate of return that was insufficient to generate the necessary new investment. They were similar to the costs of capital indicated to the CC by the CAA; but they were lower than those put forward by BAA and higher than suggested by BA.

14. The price control references also require the CC to consider whether the airport company has pursued any course of conduct against the public interest. The CC found that both Heathrow and Gatwick airports had acted against the public interest by failing to manage security queuing and queue times so as to avoid unacceptable delays to passengers, crew and flights. The CC therefore recommended that the CAA extends the existing conditions imposed in 2003 relating to service standards and introduces certain new conditions in terms of both service processes and procedures. It is for the CAA to impose such conditions as it considers necessary to remedy the adverse effects the CC has identified.

15. The CAA is currently considering the CC's recommendations before commencing its final consultation within the next few days prior to reaching its final decision in time for implementation from April 2008.

DE-DESIGNATION

16. As noted above, the DfT is currently consulting on the CAA's suggestion that there is sufficient competition from other airports to constrain BAA's ability to raise its prices at *Stansted*, in which case the airport should be de-designated so that there would be no CAA-set price control as from 1 April 2009. If the airport is not de-designated then the CC will carry out a Q5 review during 2008.

17. The CAA has also recommended that local authority-owned *Manchester* Airport should be de-designated, and the DfT is consulting on this proposal as well.

November 2007

Memorandum from Stop Stansted Expansion (BAA 13)

1. INTRODUCTION

1.1 The fragility of the commercial case for a second runway at Stansted Airport has led SSE, more than any of the other UK airport community groups, to take an active interest in the regulatory framework which applies to the designated London airports and in the nature and effect of BAA's dominant market position. In recent years SSE has carried out considerable analysis in these areas and has submitted a number of papers to the CAA relating to the regulatory arrangements. In addition, SSE has closely monitored the financial performance of BAA over the past five years, including its performance post-acquisition and the structure and funding of the 2006 acquisition.

1.2 SSE welcomed the decision of the Office of Fair Trading ("OFT") in March 2007 to refer BAA to the Competition Commission ("CC") for a full market investigation. SSE has made submissions both to the OFT and the CC and we make no attempt to repeat these arguments here or to anticipate the outcome of the CC investigation. Instead, the focus of this paper is upon two other issues which we consider are highly relevant to the Transport Committee's inquiry into the future of BAA, namely:

- The 2006 Acquisition of BAA
- Airport De-designation

2. ACQUISITION OF BAA IN 2006 BY GRUPO FERROVIAL SA

2.1 The acquisition of BAA in June 2006 by a consortium led by Grupo Ferrovial SA has, in our view, been a far more destabilising event than any of the other events which have put the company in the spotlight over the past 18 months. Indeed it has in our view been the root cause of many of these events because it resulted in the departure of many experienced senior managers from the company and many of the problems experienced by BAA over the past 18 months may well not have arisen, or at least could have been more effectively dealt with, had there been steadier hands on the tiller.

2.2 For the future, however, the burden of debt taken on to fund the acquisition is the key issue and which, in our view, *will lead to the effective break-up of BAA regardless of the outcome of the CC report*. The reasons for this assessment are set out below.

2.3 SSE has examined the most recent accounts for the chain of companies which lie between BAA Ltd and Grupo Ferrovial SA, the ultimate parent company. For the record, the structure is:

- BAA Ltd is the operating company controlling the seven UK airports (100% ownership) each established as a separate limited company. The other main BAA subsidiaries are World Duty Free Europe Ltd (100%) and Naples Airport¹⁷ (65%);
- BAA Ltd is a wholly-owned subsidiary of ADI Finance 1 Ltd, which is a wholly-owned subsidiary of ADI Finance 2 Ltd, which is a wholly-owned subsidiary of Airport Development and Investment Ltd (“ADI”) which is a wholly-owned subsidiary of FGP Topco Ltd (“FGP”);
- FGP Topco is owned by the Ferrovial Infraestructuras SA (62%), Casse de Depot et Placement du Quebec¹⁸ (28%) and Baker Street Investments Pte Ltd¹⁹ (10%);
- Ferrovial Infraestructuras SA is effectively a wholly-owned subsidiary (99.99%) of Grupo Ferrovial (“Ferrovial”), a company quoted on the Madrid Stock Exchange.

2.4 Accounts filed for BAA/ADI/FGP for the period ending 31 December 2006 enable the following to be ascertained:

	<i>BAA</i> £m (9 months)	<i>ADI</i> £m (6 months)	<i>FGP</i> £m (6 months)
<i>Period ending 31.12. 2006</i>			
EBITDA (earnings before interest, tax, depreciation and amortization)	972	611	611
<i>Annualised</i>	1290	1174	1174
Net debt	6,299	17,560*	13,417
Net financing costs	138	500	428
Underlying financing costs**	301	662	590
<i>Annualised</i>	399	1,272	1,133
Effective interest rate	6.34%	7.24%	8.44%

* Includes £5.1 billion parent company loan

** After adding back capitalised interest and incorporating amortized bank fees.

2.5 The above data, when considered alongside the capital investment programme expected of BAA over the coming years, leads us to the view that significant asset disposals will be necessary if BAA is to fund its capital investment programme.

2.6 Since 31 December 2006, ADI’s underlying debt will have been reduced by the disposal proceeds from the sale of Budapest Airport (£1.31 billion) and of BAA’s minority stakes in the Australian airports (£340 million). These disposal proceeds will reduce the financing costs to about £1 billion a year. Refinancing the acquisition debt could reduce the annual financing costs by £150 million–£200 million a year. This produces a net position broadly in line with the information provided by BAA to the CC earlier this year:

“We also understand from BAA that the budgeted interest charge for the 2007 calendar year is £820 million for the ADI group (including BAA).”²⁰

2.7 Disposal of World Duty Free and BAA’s stakes in Naples Airport and its Property JV with Morley Fund Management could raise a further £1bn and reduce annual financing costs to about £750 million a year, leaving about £450 million rising to about £550 million a year over the next three years in free cash flow to finance the investment programme. However this is only about half of the £3 billion required to fund BAA’s investment programme over the next three years—and thereafter the annual investment needed becomes even larger as a result of the plans for new runways at Stansted and Heathrow.

¹⁷ Societa Gestione Servizi Aeroporti Campani.

¹⁸ Translates as “Quebec Deposit and Investment Fund”, a Canadian pension fund management company.

¹⁹ Baker Street Investments Pte Ltd is a subsidiary of GIC Special Investments Pte Ltd, the international investment arm of the Government of Singapore.

²⁰ “BAA Ltd: A report on the economic regulation of the London airports companies (Heathrow Airport Ltd and Gatwick Airport Ltd)”, Competition Commission, October 2007, para 6.10.

2.8 In our view it is extremely unlikely that Ferrovial could inject further capital into BAA/ADI either by way of equity or debt. Ferrovial currently has net debt of €31.3 billion (£21.9 billion)—almost four times its market capitalisation. We therefore consider it likely that Ferrovial will seek, over the next three years, to dispose of £3 billion–£5 billion of UK airport assets.

2.9 In deciding which assets to sell, Ferrovial will be mindful of the CC inquiry. We would expect Gatwick plus either Edinburgh or Glasgow to be the minimum package (c.£3 billion) and Stansted to be the third candidate for disposal if the maximum package (c.£5 billion) was required. Disposal of Stansted would not only raise additional capital but would also reduce BAA's investment programme. In addition, BAA anticipates that there would be a very low, or even negative, return on investment in a second runway at Stansted:

“BAA did not provide a view as to the future cost of capital at Stansted in its September 2006 regulatory submission, instead pointing out that its assumptions about the opening date and price resulted in a rate of return of just over 8% pre-tax real over Q5 and Q6. However, BAA subsequently wrote to the CAA indicating that in its current view the cost of capital at Stansted (on a pre-tax, real basis) was 8.79%.”²¹

2.10 It should be noted that, from a competition perspective, disposal of Gatwick alone would still leave BAA with a very dominant position in the south east (more than 80% of the market) in 10 years time because the only new runways that are planned are at Heathrow and Stansted. It would therefore better serve the interests of creating competition if Stansted were to be sold—or, of course, both Gatwick and Stansted.

3. AIRPORT DE-DESIGNATION

3.1 SSE supports airport de-designation but the current proposal by the Department for Transport (DfT) to de-designate Stansted is premature and is being advanced on the grounds of expediency. Moreover there are potentially very substantial financial benefits to the Exchequer if the de-designation of UK airports is properly handled. We estimate that these may be of the order of £9 billion to £12 billion. However these potential financial benefits—despite their magnitude—have been totally ignored by the DfT in its rush to de-designate Stansted (and Manchester) airport(s), a point we shall return to later.

3.2 If the CAA were to be released from its duties under Section 39 of the 1986 Airports Act to regulate airport charges at Stansted, prices would rise and thereby assist both in the financing of a second runway at Stansted and in improving its commercial viability. We view this as seeking to circumvent the safeguards that were put in place by Parliament to prevent unfair competition and abuse of market power following the privatisation of BAA in 1987 as a single entity thereby leaving it in a dominant market position in the south east through its ownership of Heathrow, Gatwick and Stansted.

3.3 Section 2, page 20 of the 1987 BAA privatisation prospectus (“the Prospectus”) stated:

“Heathrow, Gatwick and Stansted airports have been designated by the Secretary of State for economic regulation purposes under the Act.”

and

“It is open to the Secretary of State to designate other BAA airports.”

The Prospectus went on to warn potential investors that price caps would restrain the future profitability of BAA and listed the CAA's statutory duties in this respect, as defined by Section 39 of the 1986 Airports Act. The Prospectus made no mention of the possibility of any of the designated BAA airports being de-designated. If BAA airports were now to be de-designated then, clearly, the Prospectus sold the taxpayer short.

3.4 The designation of Stansted over the past 20 years has been meaningless in terms of price control because Stansted has had no market power and has not, until this year, been able to price up to the level permitted by the regulatory cap. Stansted has been able to benefit from designation over this time because this has enabled it to be cross-subsidised by Heathrow and Gatwick users. It would be perverse if Stansted were now to be removed from the regulatory framework just at the moment when it finally has some market power. The DfT is, in effect, proposing that an arrangement which has distorted the market over the past 20 years should now be reversed so as to enable market distortion to continue into the future.

²¹ “Airports Price Control Review—Initial Proposals for Heathrow, Gatwick and Stansted”, CAA, Dec 2006.

3.5 The likelihood of Stansted having significant market power over the next 10 years or so should not be in doubt at the DfT. In the 2003 Air Transport White Paper (“ATWP”) much was made of the shortage of airport capacity in the south east, for example:

*“Because we expect there to be an increasingly severe shortage of runway capacity at the major South East airports over the remainder of this decade, making full use of the available capacity at Stansted will be essential to avoid stifling growth.”*²²

3.6 Quantification of the capacity shortage can be arrived at by examining the DfT’s demand and supply analysis in the ATWP and its supporting documents such as “Passenger Forecasts: Additional Analysis”, published concurrently with the ATWP, as well as in the consultation documents leading up to the publication of the ATWP. More recently, the December 2006 ATWP Progress Report confirms the DfT’s view regarding the shortage of airport capacity in the south east, specifically referring to ‘the congested south east’ and confirming the expectation that demand will continue to outstrip supply:

*“Our new forecasts remain fully in line with what we said in 2003.”*²³

and

*“... the additional airport development supported in the White Paper would not be sufficient to support all of this unconstrained demand.”*²⁴

3.7 Given the DfT’s view that capacity in the south east is insufficient to meet present and future demand to 2030, the de-designation of Stansted is bound to result in higher airport charges and the DfT intends the airport operator to be the sole beneficiary. We would question whether this is consistent with the policy statement in the ATWP that:

*“The Government will not promote or pay for the development of Stansted.”*²⁵

3.8 In any market, competition depends upon there being competing providers of capacity and a degree of excess capacity so that real choices can be made. On both counts, it follows that it would be premature to de-designate Stansted at a time when (i) it remains an integral part of the BAA London airports “system” and (ii) there is a capacity shortage in the south east. Although expansion plans exist for Luton and Heathrow, these, even if implemented, will not materially add to capacity for several years.

3.9 The current CC investigation into BAA will provide evidence, analysis and insights into the workings of the airports market in the south east which will be invaluable in informing the decision on whether Stansted should be de-designated. In our view it would be both premature and irrational to de-designate Stansted ahead of the CC’s report.

FINANCIAL OPPORTUNITY

3.10 One of our main reasons for supporting de-designation is the very substantial potential benefit to the Exchequer. Removal of price controls at Stansted would enable BAA to increase airport charges and the additional revenues would drop down in full to EBITDA. The value of this can be estimated by looking at the EBITDA multiples paid for airport businesses in recent acquisitions which have been in the range $15 \times$ – $20 \times$ (some have been much higher)²⁶—ie an additional £1 million of annual EBITDA adds £15 million–£20 million to the value of the business.

3.11 If the CC report were to recommend a break-up of BAA in the south east, Gatwick and Stansted airports could be de-designated immediately thereafter. De-designation of Heathrow would need to be on a phased basis to allow users time to adjust. (Manchester Airport could be de-designated now subject only to agreement between the airport operator and the Exchequer on the price to be paid for de-designation.)

3.12 Competition is always preferable to regulation and so the aim should be to establish the conditions for competition, de-designate all four airports which are presently designated as soon as practicable thereafter, dismantle the present system of economic regulation and thereby enable airport charges to increase to market clearing levels.

3.13 In the absence of a permanent regulator for the designated airports, reliance would be placed on the general framework of UK/EU competition law to deal with any individual cases of abuse of market power or operators acting in a way which had an adverse effect on competition and/or a detrimental effect on customers resulting therefrom. This is the framework which presently applies to every other UK airport and appears to work effectively even though almost all airports are to some extent monopolies.

²² ATWP, para 11.26.

²³ *Ibid*, para 4.10.

²⁴ *Ibid*, para 4.11.

²⁵ *Ibid*, page 118.

²⁶ Budapest (2005) \times 28; Bratislava (2006) \times 23; London City (2006) \times 28.

3.14 Following de-designation airport charges at Heathrow, Gatwick and Stansted would be able to move towards market clearing levels and this would have wider benefits, as a leading City analyst argued in a May 2006 research note:

“20 years of utility regulation have left Heathrow underpriced and undervalued in relative economic terms . . . Capacity can be better rationed through something closer to open-market pricing, having the effect of driving out the operators of small aircraft or uneconomic routes who are only using Heathrow because of the artificially low aeronautical charges, thereby freeing up capacity, lowering the investment requirement of BAA and reducing the planning and environmental pressure.”²⁷

3.15 At privatisation in 1987, airport charges at Heathrow were £6.69 per passenger and in 2006 had risen to £7.89, an average annual increase of only 0.6%. If Heathrow charges had kept pace with inflation, they would be over £13.00 today. Therefore it is no surprise that there is such demand for further capacity at Heathrow or that Heathrow slots change hands for substantial sums of money. Airport charges are significantly lower at the BAA London airports than at comparable European airports. The 2005 TRL review of airport charges ranked Heathrow at 27 and Gatwick at 44 in a worldwide league table of charges at 50 major airports.²⁸ Stansted did not even make it into the top 50.

3.16 As an illustration of the potential financial benefit of de-designation, let us assume this takes place in 2012–13 (as the midpoint in a phased programme) and leads to an uplift in airport charges per passenger of £5. By 2012–13, the total number of passengers forecast for the four designated airports is 186 million.²⁹ An EBITDA multiple of 15–20 produces a value added figure in the range of £14.0 billion to £18.6 billion.³⁰ Clearly, this would need to be shared with the airport owner in order to incentivise the owner to pay the price of de-designation and for the purposes of this illustration we have assumed a split of : giving a net benefit to the Exchequer of £9.3bn to £12.4bn, allowing for some phasing. The airport owner would include the cost of de-designation on his balance sheet and amortize over a period of time. Any examination by the OFT or CC into whether the airport was making excess profits would have regard to this expense.

3.17 In addition to the financial benefit to the Exchequer, the wider benefits described in the analyst’s note above should not be underestimated. A further benefit of de-designation of the London airports would be to encourage greater use of regional airports and thereby reduce the present over-concentration of air travel upon airports in the south east.

3.18 SSE has pointed out to the DfT that any hasty decision to de-designate Stansted (and Manchester) airport(s) without securing a financial benefit for the taxpayer would set a precedent and undermine the ability of the Exchequer to secure a price for the future de-designation of Gatwick and Heathrow, where de-designation would have a far higher value. We urge the Transport Committee to pursue this matter with the DfT.

November 2007

Supplementary memorandum from Stop Stansted Expansion (BAA 13a)

We spoke briefly after the evidence session on 28 November when I expressed concern over evidence given to the Committee by Sir Nigel Rudd and Mr Nelson of BAA in relation to the risk assumptions in the Q5 regulatory settlement. I have now been able to check the transcript and this confirms my initial hearing of their remarks. Therefore, in line with your suggestion I am writing to provide the Committee with the correct information and context.

Sir Nigel and Mr Nelson both told the Committee that the reduction in the cost of capital for Heathrow, as proposed by the CAA and endorsed by the Competition Commission (“CC”), was unreasonable because it amounted to a judgment by the regulators that the business risks of running Heathrow have gone substantially down. Sir Nigel went on to say that the parent company (Ferrovial) were “surprised and shocked by the reduction from 7.75% to 6.2% per cent in the present review”. However, the fact is that the reduction in cost of capital arises, not because the CAA and the CC consider there is now less risk in the business, but because of the higher level of assumed gearing (ie debt as a proportion of debt + equity).

²⁷ Dresdner Kleinwort Wasserstein Research Note, Mark McVicar, May 2006.

²⁸ “Review of Airport Charges 2005”, Transport Research Laboratory, Oct 2005.

²⁹ Taken directly from the most recent forecasts published by BAA and Manchester Airport.

³⁰ 186 million × £5 = £930 million pa × 15 = £14.0 billion, × 20 = £18.6 billion.

The Q5 settlement is based on gearing of 60% compared to 25% in Q4 and this is what gives rise to the reduction in the cost of capital, not an assumption of reduced business risk. In fact, both the CAA and the CC allowed for **higher** business risk in Q5 vs Q4: both applied a higher equity beta in Q5; both allowed a higher cost of equity; and both allowed for a higher debt premium. The slight reduction in the cost of debt (from 3.78% to 3.55%—see table below) arises from the general movement in interest rates and is not specific to BAA. The effect of gearing can be readily seen by comparing the CC’s mid-point assessments of BAA’s cost of equity and debt at Heathrow for Q4 and Q5 (both expressed in pre-tax, real terms).

CC mid-point estimates	Q4	Q5
Cost of equity	8.35%	10.19%
Cost of debt	3.78%	3.55%
Gearing	25.0%	60.0%
Weighted Average Cost of Capital (“WACC”) ³¹	7.22%	6.12%

Note that the 7.22% WACC figure above was increased to 7.75% for Q4 for reasons which do not apply in Q5, namely: (i) T5 construction cost risks and (ii) smoothing of the downward trend in the equity risk premium. In addition an average WACC was applied to Heathrow, Gatwick and Stansted. If Heathrow had been considered on a standalone basis in Q4, the applicable WACC would have been lower.

The CAA, using slightly different methodology, arrived at very similar “bottom line” figures to the CC figures shown in the above table both for Q4 and Q5. Details of the components of the CAA and CC cost of capital estimates for Q4 and Q5 are appended, for reference.

Both the CAA and the CC considered 60% gearing for Q5 to be an appropriate assumption and comparable to other regulated utilities. The actual level of gearing in the BAA/ADI business was 99% as at 31 December 2006 and 96% as at 30 September 2007 and so Ferrovial can hardly complain that a 60% gearing assumption is excessive. In any event the CAA and the CC applied risk premia for debt and equity costs based on 60% gearing.

Most observers considered the 25% gearing assumption for Q4 as too conservative. It was based on BAA’s actual financial structure at the time and put no pressure on BAA to adopt a more efficient financial structure during Q4. Ultimately, it was this more than anything else which made the company so vulnerable to Ferrovial’s highly leveraged take-over bid in 2006.

The Q5 settlement has not yet been finalised by the CAA and it seems clear to me that Sir Nigel and Mr Nelson viewed their appearance before the Committee as an opportunity, in effect, to lobby for a more generous settlement. Whilst this is perfectly understandable, it is disappointing that, in presenting their case, they misrepresented the facts in relation to the risk assumptions.³²

I hope this clarification note is helpful to the Committee.

December 2007

Annex

Heathrow WACC

	Q5		CAA		CC
	Low	High	Low	High	Mid-point
<i>All numbers are in real terms</i>					
Gearing	60%	60%	60%	60%	60%
RFR	2.00%	2.00%	2.50%	2.50%	2.50%
Debt premium	1.00%	1.00%	1.05%	1.05%	1.05%
Pre-tax cost of debt	3.00%	3.00%	3.55%	3.55%	3.55%
ERP	4.50%	4.50%	2.50%	4.50%	4.40%
Beta (number)	1.13	1.26	0.90	1.15	1.10
Post tax cost of equity	7.09%	7.67%	4.75%	7.68%	7.34%
Taxation	30%	30%	28%	28%	28%
Pre-tax cost of equity	10.12%	10.96%	6.60%	10.66%	10.19%
Pre-tax real WACC	5.85%	6.18%	4.77%	6.39%	6.21%

³¹ WACC is the weighted average of the cost of equity and cost of debt adjusted for tax. The pre-tax formula is: $WACC = g(RFR + DP) + ((1-g)(RFR + ERP \times \beta / (1 - CT))$. . . where: g = gearing; RFR = risk-free rate; DP = debt premium; CT = corporate tax rate; ERP = equity risk premium and β = equity beta.

³² **Aviation Services for the City of London**, Oxford Economic Forecasting and The Aviation and Travel Consultancy, published by the City of London Corporation, October 2002.

Q4	CAA			CC		
<i>All numbers are in real terms</i>	<i>Existing Assets</i>	<i>New Assets</i>	<i>Heathrow Average</i>	<i>Low</i>	<i>High</i>	<i>Mid-point</i>
Gearing	25%	45%	36%	25%	25%	25.00%
RFR	3.00%	3.00%	3.00%	2.50%	2.75%	2.63%
Debt premium	0.90%	1.60%	1.28%	0.90%	1.20%	1.15%
Pre-tax cost of debt	3.90%	4.60%	4.30%	3.40%	3.95%	3.78%
ERP	4.00%	4.00%	4.00%	2.50%	4.50%	3.50%
Beta (number)	0.70	1.30	0.95	0.80	1.00	0.92
Post tax cost of equity	5.80%	8.20%	6.78%	4.50%	7.25%	5.85%
Taxation	30%	30%	30%	30%	30%	30%
Pre-tax cost of equity	8.29%	11.71%	9.69%	6.43%	10.36%	8.35%
Pre-tax real WACC	7.19%	8.51%	7.75%	5.67%	8.76%	7.21%
Supplement for additional T5 risk						0.25%
Supplement to smooth reduction in ERP						0.25%
Total						7.71%
Rounded to						7.75%

MAIN REFERENCES

- (1) "Heathrow and Gatwick airports—price control proposals", CAA, Nov 2007.
- (2) "A report on the economic regulation of the London airports companies (Heathrow Airport Ltd and Gatwick Airport Ltd)", Competition Commission, Nov 2007 (including further detail in Appendix F).
- (3) "Recommendations to the Competition Commission for Heathrow and Gatwick airports", (including supporting paper on cost of capital), CAA, March 2007.
- (4) "Airports price control review—Initial proposals for Heathrow, Gatwick and Stansted", CAA, Dec 2006; including supporting papers: XII—"Cost of capital: policy framework" (Europe Economics); XIII—"Cost of capital: estimating separate costs of capital for Heathrow & Gatwick" (Europe Economics) and XIV—"Cost of capital: capital markets context" (Ernst and Young).
- (5) "Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003–2008": CAA Decision and Annexes, CAA, Feb 2003.
- (6) "BAA plc: A report on the economic regulation of the London airports companies (Heathrow Airport Ltd, Gatwick Airport Ltd and Stansted Airport Ltd)", Competition Commission, Oct 2002.
- (7) "Heathrow, Gatwick and Stansted Airports, Price Caps, 2003-2008: CAA recommendations to the Competition Commission", CAA, March 2002.

Memorandum from Flybe Limited (BAA 14)
Synopsis

1. In the last 10 years, there has been a significant increase in airline competition in the UK, driven mainly by the growth of the low cost airlines. Whilst there has been some growth in airport competition, this has been much less effective due mainly to the overwhelming share of the market in the UK which is enjoyed by BAA.

2. The common ownership by BAA of otherwise potentially competitive airports stunts the individual airports' growth and reduces their efficiency.

3. Flybe concludes that, within the next 10 years, the Government and the industry regulators should have secured that more of the BAA airports should come under different ownership and greater competition should be encouraged. This would stimulate airport to airport competition, which will, in turn, enhance airline competition and bring additional benefits for users. It will probably also enable BAA to run its business more efficiently.

4. Flybe has built a sizeable business at Southampton Airport with no encouragement from the airports' owner, BAA. The growth in Flybe's carryings at Southampton (SOU) from 300,000 passengers in 2003 to 1.9 million passengers forecast for the current year has been achieved when the airport charges to Flybe are higher than at any other UK airport. The growth has been despite BAA, rather than with its help and encouragement.

1. INTRODUCTION

1.1 Flybe appreciates the opportunity to give evidence to the Committee's Inquiry into the future of BAA. Flybe is a low cost airline which has retained some of the frills: it has recently announced a frequent flyer scheme and offers a premium service with preferential check-in, seating and lounge facilities, in addition to its value for money, economy seats. Flybe expects to carry approximately 7.5 million passengers in the current year to 31 March 2008: of these, about 40% will be travelling on business.

1.2 Flybe's route network can conveniently be categorised into (a) regional domestic UK (b) UK region to major European city, and (c) UK region to regional France. Flybe's aim is to streamline its flying programme so that there are two aircraft types in the fleet, namely the Embraer 195 (a 118 seater jet) and the Bombardier Q400, a turbo prop aircraft with a seating capacity of 78 seats.

1.3 Flybe operates from 23 UK airports, more than any other UK airline. Of the 7.5 million passengers which Flybe expects to carry this year, about 4.0 million passengers will be on flights which operate through a BAA airport at one or both ends. Flybe operates from all the BAA owned UK airports except LHR and STN. It also carries 1.1 million passengers per annum through George Best Belfast City Airport, which Ferrovial owns.

1.4 Flybe acknowledges and accepts the Committee's proposition that BAA airports are a vital part of the UK's transport infrastructure. It is precisely because these airports, and the services which they offer, are so fundamentally important to the development of UK civil aviation that any failure on their part to meet generally accepted levels of efficiency is bound to attract the attention of the industry and its regulators.

1.5 There are many aspects of the current situation in relation to BAA which need to be addressed. Flybe will, in this written evidence, confine itself to two aspects, namely (i) Southampton Airport and (ii) the lowland Scottish airports. It will be pleased to expand its evidence in or beyond these areas as the Committee may wish.

2. SOUTHAMPTON AIRPORT (SOU)

2.1 SOU is an important regional airport in the South East of England. In many respects, SOU is comparable with Liverpool Airport (LPL), Bristol (BRS), Exeter (EXT) and Newcastle (NCL). All these airports face competition from a near neighbour, and, therefore, need to tailor their charging structure and their product with a view to encouraging airlines to maintain and expand a range of services at the airport.

2.2 For BAA, the situation is completely different. SOU's catchment area overlaps with those of London Gatwick (LGW) and London Heathrow (LHR). When Flybe operates services from SOU, it does so in direct competition with scheduled services offered by other UK and European airlines from LHR and LGW. Whilst the airport charges which BAA can levy at LHR and LGW are regulated under the Airports Act 1986, this is not the case in relation to Southampton. BAA, as a matter of policy, charges an additional premium to SOU services as compared to LHR and LGW because SOU is, to them, a smaller, higher risk airport.

2.3 The result for Flybe is that SOU charges the highest level of airport charge which it experiences from any airport in mainland Britain, and this is despite the success which Flybe has had in developing services there and the fact that SOU represents its largest UK base. Flybe has ambitions to increase its own carryings from SOU from the present level of approximately 2 million passengers per annum to around 5 million passengers within the next five years.

2.4 By contrast, the management of SOU has an astonishing lack of ambition. The recent White Paper³³ discussed a possible level of 7 million passengers at SOU (all airlines), yet BAA's Master Plan for SOU, published in November 2006 and prepared in response to the White Paper, contains a figure of just 3.05 million passengers by 2015.

2.5 The network of services which are available from SOU is limited in comparison with the network available at its peer airports mentioned in paragraph 2.1 above. The reason is that BAA has had no incentive to encourage the growth of a wide network in competition with existing services from LHR and LGW.

2.6 The experience of airport competition in the UK (eg Belfast International/George Best Belfast City, Manchester/Liverpool, Bristol/Exeter etc) leads to the conclusion that, if Southampton were in the ownership of a company which was single-mindedly determined to develop the airport in competition with Heathrow and Gatwick, airport charges would fall and airlines and passengers would respond to the wider range of services available from a more pro-active management.

³³ The Future Development of Air Transport in the United Kingdom: Department for Transport: July 2002.

3. THE SCOTTISH LOWLAND AIRPORTS

3.1 Edinburgh and Glasgow airports are less than 30 miles apart. As with the Belfast Airports, there is a core of passengers who would prefer to use Edinburgh, another core which is dedicated to Glasgow, and a substantial majority who will choose between the two depending on what is on offer in relation to their individual requirements.

3.2 Prestwick Airport offers some competition but only in relation to passengers travelling for leisure purposes.

3.3 Edinburgh and Glasgow Airports are in the same ownership. Flybe has experienced in the past negotiating tactics on the part of BAA to the extent that an airport charge which had been offered in relation to a new route from Edinburgh would be reduced if the airline also agreed to fly to the same destination from Glasgow.

3.4 Prestwick Airport was sold by BAA more than 10 years ago. If BAA were required to divest themselves of either Edinburgh or Glasgow, then the prospect for active inter-airport competition in the lowlands of Scotland would be very bright indeed and this would provide the prospect of a wider range of services at lower fares.

4. CONCLUSION

4.1 Flybe is convinced that a better result would be achieved for the consumer if there were to be a breakup of the BAA owned airports to the extent suggested above. There are other pressures currently on the management of BAA which the Committee will no doubt address. Flybe remains willing to provide oral evidence in support of what is said above, or to expand on this document as required.

November 2007

Memorandum from BAA Ltd (BAA 15)

EXECUTIVE SUMMARY

Unprecedented scrutiny of BAA—The company is facing investigation by the Competition Commission, the CAA, and the Select Committee. Most importantly, BAA continues to face pressure from its passengers and airline customers to deliver a world class airport experience.

Service standards are improving—The London airports are full. The government's changes in security put all airports under severe strain. Service quality suffered as a result. A world class airport experience can only be delivered when capacity is delivered. However, BAA is investing in significant numbers of security guards, which are resulting in real improvements. Today, queues are shorter and the airports are cleaner.

Airport facilities are being transformed—Terminal 5 will open in March 2008, on time and on budget. Planning permission has been secured for another terminal of similar scale and quality in the East of Heathrow. We expect regulatory approval for Heathrow East and the complete renovation of Gatwick. T5 will represent the world-leading standard to which we will aspire.

New runway capacity is essential—The main issue in the South East is a lack of capacity. This was recognised by the Government's Air Transport White Paper. BAA is working as fast as possible to deliver a new runway at Stansted. Pending further government consultation, work continues on new runway capacity at Heathrow. Meanwhile, we are awaiting the result of the application to increase the cap on passenger numbers at Stansted.

A stable ownership structure will ensure capacity is delivered—We note that the Select Committee has previously called for BAA's break-up. We consider the case for break-up to be weak, in that it does not appear to have considered the fundamental questions surrounding the delivery of new capacity. Genuine competition would only be possible with that new capacity. T5 is the future. BAA has ambitious plans for all its airports and a stable ownership structure is a key aspect of transforming airports.

THE CONTEXT FOR THE COMMITTEE'S INQUIRY

The Transport Select Committee inquiry into the "Future of BAA" comes at an important time for the company and its airports.

London's airports currently face significant pressures, with runways and terminals operating at full capacity for most of the time, against a background where there is an increased threat of terrorist activity, and where the underlying demand for air transport continues to grow. At the same time, there is renewed

awareness of the fundamental economic importance of good air transport links to Britain's global connectivity and a growing consensus around the need to provide the airport facilities to support such services, whilst recognising their environmental impact.

It is right, therefore, that the Committee understands from BAA and others how they are responding to these challenges. We recognise that the Committee will want to examine legitimate questions about operational performance, particularly in relation to security and the reality that airports and the wider public now have to accept that terrorism will present a daily threat for the foreseeable future.

The events of the last year also highlighted a number of important areas where the passenger experience is far from satisfactory, but where these issues can be resolved only in cooperation with the agencies which have primary responsibility for delivering the services in question. To achieve significant improvements in these areas, BAA believes that airports, airlines, handling agents and Government agencies must commit to working more closely together. BAA is fully committed to doing everything it can to reach that consensus and is prepared to take a lead role in doing so.

At our Scottish airports, and at Southampton we are proud of the collaborative working that we have with our stakeholders. These close working relationships, along with the lack of capacity constraints, have enabled the airports to respond more quickly and flexibly to events than our capacity constrained London airports.

A CRITICAL TIME FOR AIRPORTS

Decisions taken this coming year will determine whether our airports, and Heathrow in particular, will be globally competitive for decades to come. We therefore believe that we are at a critical juncture in the development of air travel in this country. For this reason we would encourage the Committee to examine the strategic and ultimately fundamental questions that we face this year, each of which will have a direct impact on the UK's infrastructure over the short, medium and long-term.

Members of the public and the members of the Select Committee, will, of course, make up their own minds, but BAA believes that the opening of Terminal 5 in March will deliver a state of the art, world class facility which represents a quantum leap in the service we can offer passengers. But what Terminal 5 will also illustrate is the qualitative gap between it and many of our facilities which, while we are doing everything we can to improve, suffer from the fact that they were built in a different era.

Therefore the key questions we face today are not just how we continue to improve our performance on a daily basis within the existing facilities, but also how we guarantee sustained investment levels sufficient to renew our airports, thereby improving the competitiveness of the UK.

BAA, and its owners, are fully committed to meeting that challenge in the short, medium and long term. We are committed to transforming facilities, standards and capacity at Heathrow and our other airports and investing to deliver a lasting legacy—including investing in new runways at Stansted and Heathrow.

PUTTING THE PASSENGER FIRST

Airports today face threats that simply did not exist when the existing terminals were built. The safety and security of our passengers and staff is, and will always be, our number one priority, and BAA will do everything in its power to protect passengers.

However, the significant and sudden changes in security procedures, announced by the DfT in August 2006 and beyond continue to make life more difficult for travellers. BAA's airports have responded by investing heavily in new staff and equipment to reduce queues, whilst maintaining security standards. Since August 2006, BAA has:

- recruited over 1,500 new security officers at our seven UK airports, representing an increase of around 30% on the security staff employed in Summer 2006—by December 2007, this figure will be 50%;
- opened 20% more security lanes at the London airports by reorganising existing space and removing retail outlets—by December, more lanes will have been opened in the last 12 months than in the previous 10 years;
- invested in new archway metal detectors and x-ray screening equipment that BAA expects, by working with the DfT, will lead to improvements in the security processes currently in place;
- trialled body scanning technology, and fingerprint and iris identification at the airports to explore ways of improving passenger throughput; and
- worked closely with airlines and the UK's Department for Transport to take advantage of improvements in security technology.

Taken together, these additional resources and a series of process improvements have so far increased the airports' overall security capacity by around a quarter. As a result, there have been significant improvements in security queuing during the Summer holiday period, which is typically the airports' busiest time. At Heathrow during July and August, 97% of the time passengers spent less than ten minutes queuing for security in the central search area. At Gatwick during the same period, 86% of the time passengers queued for less than ten minutes. At Stansted, as well as our other airports, our security queuing performance has improved substantially.

Improved security performance is only one key element of BAA's programme to deliver rapid improvements in the level of service at the airports. The second element is focused on improving the availability of equipment that passengers use, such as lifts and escalators. Over a relatively short period of time, the airports have achieved much higher levels of reliability and availability by working more closely with maintenance providers. The third element is designed to enhance the overall cleanliness and appearance of the airports. In the current year, airports have received more than £25 million in additional funds to clean, repair and improve existing facilities.

AIRPORTS ARE INVESTING TO TRANSFORM THE PASSENGER EXPERIENCE

To deliver higher levels of passenger experience, BAA is clear that significant additional investment will also be needed to replace and renew existing terminal facilities, particularly at Heathrow and Gatwick. Some of this investment has been in the pipeline for many years and is now nearing completion. Terminal 5, when it opens on 27 March 2008, will provide a world-class facility that will set the standard, both in this country and internationally, for the travelling public in terms of quality, comfort, speed, security, and environmental sustainability.

By taking nearly all of British Airways' flights and passengers, Terminal 5 will alleviate congestion and creating a better environment for passengers, and provide the extra space to start rebuilding and refurbishing the rest of the airport. Terminal 5 will become the new benchmark for passenger experience. Bringing facilities up this standard will entail the replacement of Terminal 1, Terminal 2 and the Queens Building with Heathrow East Terminal ("HET"), a new terminal that will provide capacity for around 30 million passengers a year. BAA will also continue with the extensive refurbishment of Terminal 3 and Terminal 4.

In all, over the next ten years, BAA is planning to invest a total of £4 billion in the refurbishment and renewal of Heathrow's existing facilities. BAA believes that this will transform passengers' experience of using the airport, and provide London with the world-class international gateway that it demands.

At Gatwick, BAA has developed ambitious plans that will deliver an improved experience for passengers, and provide appropriate capacity to support the airport's growth. These will entail extending the North Terminal and developing an additional pier to provide improved levels of service. In addition, BAA will be investing heavily to improve the South Terminal, including the complete redevelopment of the arrivals and departures concourse, improvements to the baggage system and a proposal to reconfigure the South Terminal forecourt and create an integrated transport interchange. The South Terminal's baggage system will also be improved to deliver operational efficiencies for airlines. In all, BAA is planning to invest a total of £1.2 billion over the next decade in the refurbishment and renewal of Gatwick.

At Stansted, BAA is currently extending the existing terminal building to provide additional space for arriving passengers. Stansted is also seeking planning permission to lift the current cap of 25 million passengers a year, to enable the airport to grow to around 35 million passengers a year by 2015. This growth will be supported by investment in further development of terminal facilities and airside infrastructure, at an expected cost of some £520 million.

In Scotland, BAA has transformed its airports in the last ten years—through sustained investment in terminal capacity, passenger facilities and international routes. Over the next 10 years, BAA will do so again. Similarly, BAA is investing in Southampton Airport, to the obvious benefit of its passengers in the South of England.

PASSENGERS AND AIRLINES NEED NEW RUNWAY CAPACITY

However, none of this investment in facilities reduces the fundamental need for new runway capacity at London's airports. Since BAA opened its last new terminal at Stansted in 1991, the annual throughput at BAA's London airports has grown by over 60 million passengers. At Heathrow alone, passenger throughput has grown from 42 million passengers in 1991 to the current level of 67 million passengers a year. This level of growth has put terminals and infrastructure under enormous pressure.

It is clear from recent experience that a failure to develop new airport capacity will have wide ranging effects on passengers, airlines and the wider UK economy. Capacity constraints progressively drive up the costs of travel as airlines raise fares, and limit the range of destinations and frequencies available from London's airports.

While Terminal 5 demonstrates what BAA is capable of achieving in terms of construction, innovation, and customer service, it is one of the clearest examples of how the UK planning system has frustrated major infrastructure developments that are clearly in the national interest. Before the start of the planning inquiry, BAA was anticipating that Terminal 5 would be open by 2001. When it opens next March, more than 400 million passengers will have passed through Heathrow in the years since the new terminal could have opened. These passengers have undoubtedly endured poorer levels of service than they would have done if Terminal 5 had opened earlier and Heathrow and London's reputation has suffered as a result.

Much of the delay in delivering Terminal 5 is attributable to the historic lack of a clear and up to date policy for airport development. To address this the Government published the Air Transport White Paper in 2003, setting out a clear strategic framework for the development of airport capacity over the next 30 years. The White Paper provides airports in the South East and Scotland with the support needed to bring forward and deliver proposals for new terminal and runway capacity more quickly than in the past. In this regard, BAA also welcomes the Government's proposals to improve the planning process for major infrastructure projects through the adoption of national policy statements, similar to the White Paper.

DELIVERING NEW RUNWAY CAPACITY

Since 2003, BAA has been working vigorously to develop proposals for the new capacity envisaged by the White Paper, both in terms of new runways and also—at Heathrow—using existing capacity more efficiently. At Stansted, BAA has been working on the development of proposals for a second runway to increase the airport's capacity to around 68 million passengers a year by 2030. This process has involved extensive public consultation, and significant joint working with a range of delivery agencies. In total, BAA has spent around £125 million developing the proposals and addressing blight caused by the prospect of the second runway. BAA is now preparing to submit the planning applications and associated orders for the new runway and supporting infrastructure, with a planning inquiry expected to begin in 2008. The forthcoming planning process and the subsequent construction programme mean that the new runway should be operational by 2015.

At Heathrow, the DfT is about to consult on the future development of the airport, including the potential for mixed mode operation and a third runway. Subject to the outcome of the Government's consultation, BAA expects to bring forward proposals for mixed mode and/or a third runway as soon as possible, and will then work to deliver the new capacity at the earliest opportunity. Over the next five years, BAA anticipates that it may need to spend in excess of £500 million developing proposals for additional capacity at Heathrow, acquiring land and addressing the blight caused by the proposals.

BAA's experience of delivering Terminal 5 has shown that delivering major infrastructure projects takes considerable time, experience and expertise as well as significant financial commitment and a sizeable appetite for risk. Following the White Paper, BAA has demonstrated its continued willingness to invest in the delivery of new airport capacity for the benefit of passengers, airlines and the wider economy, at no cost to the taxpayer. These capacity projects have assumed even greater importance, following decisions by Luton and Birmingham airports not to pursue the capacity opportunities set out by the White Paper.

However, it is clear that the successful delivery of major projects will continue to require the sustained engagement of Government and other stakeholders. This support will be necessary to help airports coordinate the delivery of the associated infrastructure, such as roads, rail, local planning and airspace. It will also be vital for the Government to maintain its firm policy support for additional runway capacity at both airports, to ensure these projects can be delivered through the planning system in a timely way. As Terminal 5 has shown, delays in delivering new capacity can have serious consequences for passengers, airlines and the wider economy.

A FRESH APPROACH TO AIRPORT REGULATION

As the CAA approaches the conclusion of the Q5 price control process, BAA believes that it is an appropriate time to carry out a thorough review of the need for economic regulation at designated airports and, where continued regulation is appropriate, to determine what form that regulation should take. These are pressing issues that require detailed consideration to ensure that airports receive the support from the regulatory framework they need to deliver higher levels of service and major investment in new capacity. As such, BAA welcomes the CC's intention to look closely at the issue of economic regulation during its market investigation. The areas that BAA would suggest need scrutiny include:

- the CAA's duties should be changed to put passengers first;
- the need for greater alignment between the regulatory framework and Government policy;
- addressing the inconsistencies between five-year price controls and thirty-year investments;
- opportunities to put more weight on airport-airline negotiation without regulatory intervention; and
- the merits in simplifying the price control process by making the CC an appellate body.

The starting point for the CC's review should be that regulation should only be imposed where there are compelling reasons to do so and only to the degree that it is necessary. BAA believes there is a strong case for exploring a more airport-specific approach to regulation which recognises the individual circumstances and characteristics of the airport in question. In this respect, BAA is encouraged by the prospect of de-designation at Stansted, which it considers will benefit passengers by creating clearer and more stable incentives for investment in new capacity.

At Heathrow and Gatwick, the system of regulation has reached a crossroads. At one extreme, the regulator could adopt a utility-style approach, with much greater levels of intervention and control. However, BAA does not believe there should be any presumption that solutions to the current challenges can be found in applying tighter regulation. BAA's preferred approach would be for a more commercial approach, with greater use of ex-post regulatory oversight to monitor airports' performance. BAA believes this framework would create stronger incentives for airports to deliver higher services levels, and provide the necessary incentives to support airports in delivering new capacity.

BREAK-UP WILL NOT CREATE COMPETITION BETWEEN BAA'S AIRPORTS

Following the reference by the Office of Fair Trading in March 2007, the CC is required to investigate the supply of airports services by BAA, to see if any feature, or combination of features, of the market prevents, restricts or distorts competition. Coming to a view on the relevant issues will require detailed work, and the CC's investigation is expected to last between 18 months and two years.

BAA is aware of the Committee's previous conclusions on the issue of BAA's ownership structure, but the company maintains its firm belief that separate ownership would not create competition, either in the South East or in Scotland.

BAA looks forward to putting the case for retention of the existing ownership structure to the CC. We would suggest that consideration of any alternative ownership structure would need to address the following questions:

- how can there be competition between airports without spare capacity?
- how can price-controlled airport compete on price?
- how would separate owners deliver capacity any faster than BAA?
- how would the inevitable delays in delivering service improvements and new capacity, caused by break-up, be addressed?
- would separate owners have the necessary skills and experience?
- would separate owners have the financial strength of BAA?

The CC's market inquiry is also looking at whether separate ownership would lead to competition between BAA's Scottish airports. BAA has an excellent record in Scotland for delivering investment, passenger growth, route expansions and reductions in airport charges. BAA would draw the Committee's attention to the CC's observation that there has been little expression of concern about BAA Scotland's performance by airlines and other stakeholders and, in fact, several prominent organisations in Scotland have openly supported BAA's ownership of its three Scottish airports. Moreover, BAA considers that its airports are not regarded as good substitutes by a material number of passengers. This limited potential substitutability means that there is virtually no scope for competition between the airports, and separate ownership would not be expected to lead to competition between BAA's Scottish airports.

CONCLUSION

The issues BAA faces are complex, but they are also both urgent and fundamental to the long-term interests of this country. As a company, BAA stands ready to address those issues in the short, medium and long-term. We accept our responsibility to improve our daily performance at the same time as doing all we can to make our airports secure. We also have a clear vision of how we need to transform our facilities to make the quantum leap that will be necessary if they are to remain globally competitive. The opening of Terminal 5 is just the beginning of that process.

But BAA is also keenly aware that it cannot deliver either the transformation of facilities, or the development of runway capacity, on its own. That is why we welcome this opportunity to contribute to a serious debate on the fundamental issues about regulation and investment that lie of the root of many of the problems we face today. It was the failure to face up to those questions in the past which has left us with so much to do now. We now believe that we have an opportunity to make up for that deficit, and BAA is determined to use this critical period to leave a lasting legacy for this country and those who use our airports.

BAA has clear and well advanced plans for improving service quality, redeveloping and renewing existing infrastructure, and securing the planning permissions needed to expand runway capacity. At this time, the priority for passengers must be for these plans to be implemented as quickly as possible, by a management team focused on the task in-hand and working within a supportive and stable ownership structure.

Supplementary memorandum from BAA (BAA 15a)

What has BAA's approach towards a third runway been?

1. INTRODUCTION

1.1 This note explains the evolution of BAA's policy towards a third runway at Heathrow. It has been prepared for submission to the Transport Select Committee as supplementary evidence.

2. GOVERNMENT POLICY WITH RESPECT TO RUNWAY DEVELOPMENT AT PRIVATISATION

2.1 As with all major infrastructure projects, governments (of any colour) will seek to develop policy with respect to these projects. In that sense, airports are no different. The 2003 White Paper follows a long history of government deliberations on new capacity in the South East. In the decade prior to the privatisation of BAA in 1987, there had been two White Papers.

2.2 The 1978 White Paper made a forecast to 1990. It said that the then British Airports Authority proposal for a fourth terminal at Heathrow should be examined at public enquiry. It invited the—then publicly owned—British Airports Authority to bring forward proposals for a second terminal at Gatwick and the development of Stansted. Runways at the South East airports were not proposed as government policy in order to make the most efficient use of existing runway capacity.

2.3 The 1985 White Paper forecast that airport capacity would be sufficient until the mid 1990s. The Paper asked the—still publicly owned—British Airports Authority to look at options for building a fifth terminal at Heathrow. The government did not expressly support the fifth terminal, or second runways at Gatwick or Stansted. The government's policy was that there should not be a second runway at either location.

2.4 In the BAA plc privatisation prospectus of 1987, government policy is clear. One runway at Stansted is envisaged although not a second. A second runway at Gatwick is ruled out. At Heathrow, there was no mention of a third runway, although the prospectus did say that studies to release the land for Terminal 5 was underway. The prospectus repeats the conclusion—supported by BAA—that terminal capacity would be sufficient until the mid 1990s.

2.5 The 1991 MMC advice to the CAA on Q2 (1992/93 to 1996/97) does not raise BAA's approach to runway investment at Heathrow as a matter to be considered. There is discussion on the government's approach to considering the need for runways with references back to 1960's proposals for new airports at Cublington and Maplin.

3. RUCATSE

3.1 The government announced in 1990 that it would convene a working group to study the need and options for runway capacity to service the South East. This study was called Runway Capacity in South East England or RUCATSE. This study considered options at all three BAA airports, as well as the other sites throughout the region. Specifically it considered third runway sites to the north of Heathrow. The study concluded, in 1993, that there were grounds for additional runway capacity in the South East. BAA, BA and other airlines participated fully in the studies.

3.2 In 1995, the government responded. The government concluded that BAA should not consider a third runway at Heathrow or a second runway at Gatwick. The government did say that BAA should examine "less environmentally damaging options, such as a close parallel runway at Gatwick". The government also concluded that there was scope for increasing the utilisation of the existing runways at Heathrow. A report commissioned by NATS, BAA and the airlines—The Heathrow Runway Capacity Enhancement Study (RCES)—supported this conclusion.

3.3 The government pointed out that airports operated on a commercial basis and it was for those operators to bring forward proposals where they see a business case taking account of the overall framework of the government's airports policy. In this light, BAA's position was that government policy as well as commercial attractiveness were necessary pre-conditions to the promotion of a new runway in the South East.

3.4 In 1996, the Monopolies and Mergers Commission reported on its recommendations for Q3 (1997/98 to 2002/03). It concluded that

- the airlines criticisms over poor quality of investment did not lead the MMC to conclude that BAA's performance was against the public interest; and
- there were no grounds for the MMC to recommend a review of the structure of BAA.

3.5 It is noticeable that BAA's approach to runway investment at Heathrow is not raised by the airlines, or the MMC, in this report.

4. THE TERMINAL 5 INQUIRY

4.1 In March 1993, BAA submitted its planning applications for a fifth terminal at Heathrow. The public inquiry opened in May 1995 and closed in March 1999. The project provoked huge opposition from local authorities, residents and environmental groups. One of the major concerns was that the terminal would be a stalking horse for a third runway or mixed mode operations. Despite BAA's evidence to the inquiry that the fifth terminal was needed to make the most effective use of the 2 runways, this concern appeared to gain considerable traction with the inquiry inspector.

4.2 At that time, based on the government's response to the RUCATSE work, current and planned airline fleets, BAA judged that explicit support for a third runway would compromise the chances of Terminal 5 planning approval. BAA's first objective was to assure the inspector that a third runway was not linked with the proposal for a fifth terminal. We made clear that if the inspector was minded to refuse permission for Terminal 5 because of this possibility, then BAA would be willing to accept a condition concerning the construction of a third runway.

4.3 In the event, in granting permission for Terminal 5, the government did not make any definitive statement on a third runway per se, but the decision was in practice even more restrictive, since it included a planning condition restricting the use of the two existing runways to 480,000 ATMs a year. It is important to note that however that despite the ATM cap, the government did not rule out a third runway when granting permission for Terminal 5.

5. GOVERNMENT POLICY FROM 1997

5.1 A new government was elected in 1997. In 1998, the government asked BAA to cease work on the close parallel runway at Gatwick that the previous administration had asked to be done arising from RUCATSE. The government produced an Integrated Transport White Paper in 1998. It picked up the recommendation of the 1996 Transport Select Committee that UK airports policy should be prepared for 30 years ahead. It was intended—the government said—to provide the framework within which those concerned can plan for the future with greater certainty.

5.2 The work and consultation that lead up to a UK airports policy began in 1999 with the South East and East of England Regional Air Services Study (SERAS). This comprised of a fresh round of studies of air transport demand and capacity issues, with a view to setting a long-term policy on, amongst other things, when, where and how many new runways should be provided. It was intended to take into account the results of the T5 inquiry as and when that was published.

5.3 BAA considered its approach to these studies very carefully. It concluded that it should support the technical and operational studies with all necessary resources. However, BAA also concluded that it should not set out, at the outset to promote one particular location over another, for the following reasons:

- objectors would justifiably complain that BAA was attempting to prejudge the outcome before the evidence had been collected or analysed;
- if BAA were to come out in favour of one location, and the government were then to conclude in favour of a different location, it would have been more difficult to gain planning consent for either; and
- most importantly, the decision was one of broad public policy, taking account of issues which went far beyond the legitimate interests of a commercial airport operator, and it would have been presumptuous for BAA to advise the government on its overall policy priorities.

5.4 Notwithstanding this, BAA did contribute extensively to the studies, including joining with BA in proposing, financing, organising and participating in the study by Oxford Economic Forecasting which substantiated the key point that a new runway would contribute a large amount to national economic prosperity.

5.5 BAA's view that the government should look properly at the environmental consequences of new runways was validated by the amount of new evidence which emerged during the studies. In 2001, if BAA had sought to promote a third runway, it would have had to base its view on a Heathrow third runway largely on the RUCATSE analysis of the options. The environmental case was still not credible. Indeed, the short runway option which the government eventually proposed contained important layout errors which— notwithstanding BAA's advice—had not been resolved by the time the White Paper was published.

5.6 BAA would also have been accused of disregarding the issue of local air quality, which was not understood at all at the outset of the studies, and which turned out to be highly relevant to the White Paper. 5.7 In 2002, during these studies, complaints were made to the CC—as part of the Q4 (2003/04 to 2007/08) review—with respect to BAA's conduct with respect to runway development and investment. The CC concluded—

- BAA's apparent ruling out of the third runway at Heathrow made no difference to government policy and was not against the public interest;
- BAA's approach to a second runway at Gatwick—given the 2019 agreement—was not against the public interest;

- delays in the T5 planning process were largely outside of BAA's control (as agreed by the airlines);
- BAA could not be regarded as systematically under investing during Q3, and
- the lack of a long term vision at Heathrow was largely due to the T5 inquiry and the ongoing SERAS study.

6. THE WHITE PAPER

6.1 The government published the Air Transport White Paper in 2003. BAA supported all the White Paper's proposals for runways at its London airports. Indeed, BAA regarded the White Paper as a vindication of its approach, since it left open the possibility of runways at all three London airports.

6.2 To be absolutely clear, BAA supported, in its entirety, the government's policy which supported a third runway at Heathrow between 2015 and 2020 if strict environmental controls could be met. This qualification to the government's support is important. The government had not been able to conclude that the runway could be delivered within legal air quality limits; it had not been able to determine the extent of additional noise nuisance; it had not been able to establish the amount of land and number of homes likely to be lost and it had not been able to satisfy itself on road and rail access.

6.3 For BAA to have announced its intention to submit a planning application, ignoring these unresolved issues, would have been to cast itself as environmentally irresponsible and determined to forge ahead with expansion without any regard for its consequences including the blight costs associated with such proposals.

6.4 We believe that the government understood this point. This is why the DfT decided to take and keep leadership of the studies necessary to determine whether the runway would meet the environmental limits. This contrasts with Stansted where the government had been able to satisfy itself on the environmental issues and had handed the project over to BAA to lead.

6.5 The government established the Project for the Sustainable Development of Heathrow (PSDH) in 2004 with the intention of attempting to resolve the outstanding environmental issues. BAA supported this project with technical expertise, and financial assistance. At no stage and in no respect, did it decline to play a full part in the work. This is because BAA did want to find solutions which would allow the runway to proceed. For example, BAA's extensive work on air quality has been an important part of ensuring that the government could continue to support the development of the third runway.

6.6 The government is now consulting on the proposal that a runway can be constructed within strict environmental limits. This is the first time that a government has been in that positive position. Subject to the outcome of the consultation, this will allow BAA, for the first time, to promote a third runway with government support in the knowledge that there is a valid environmental case to support the runway, to match the economic benefits which it will undoubtedly bring.

7. THE SIGNIFICANCE OF GOVERNMENT POLICY

7.1 Throughout this narrative, it has been clear that BAA has recognised that runways in the South East are inherently and inevitably a matter for wider public policy and that attempts to gain permission for a new runway with government support were highly unlikely to succeed. At the Transport Select Committee hearing on November 28th, the Committee challenged this approach, suggesting that BAA should have proceeded without regard to government policy, as apparently happened in the case of the second runway at Manchester. However, the two situations are very different in three respects:

- the environmental impacts of a third Heathrow runway would be significantly greater than those associated with the second runway at Manchester;
- the communities and local authorities around Heathrow, Gatwick and Stansted are implacably opposed to further runways and extremely well organised to give force to their opposition whereas the Manchester runway commanded a high level of broad local support; and
- the local authorities in Manchester are also the owners of the airport.

7.2 In the case of the South East airports, government support is a precondition for a successful planning application for two reasons:

- there is no prospect of planning permission being granted for a major development which the government opposes; and
- there is no prospect of a planning permission being implemented without government co-operation on road, rail and other infrastructure schemes necessary for the project.

7.3 It is likely that the Heathrow investment would form part of the regulatory asset base of the airport. It would be a foolhardy company that attempted to start planning (let alone construction) on a third runway and convince the regulator that it was an efficient investment when the government's policy was not to support a third runway.

8. CONCLUSION

8.1 Runway development in the South East has been subject to government policy for decades. As with other major infrastructure projects—nuclear power stations for example—it is easier for governments to delay making decisions on major projects than make controversial, but necessary, decisions. This in part explains why no new full length runway has been constructed in the South East since the Second World War.

8.2 The government had gone so far as rule out a further runway at Heathrow in 1995. It is to the credit of BAA's approach towards the development of government policy that there is now policy support for a runway at Heathrow, as well as one at Stansted. Far from being criticised for its role with respect to government policy, BAA's role should be recognised for creating the opportunity to deliver what passengers in the South East need, which is runway capacity.

December 2007

Memorandum from British Airways plc (BAA 16)

1. INTRODUCTION

1.1 British Airways welcomes the opportunity to submit evidence to the Transport Select Committee's inquiry into "The Future of BAA".

1.2 The airline's main base is London Heathrow Airport, the UK's primary international hub airport and one of the busiest airports in the world. British Airways also operates from eight other airports in the UK, and worldwide, to 144 destinations in 72 countries. It employs more than 43,000 people, of which 38,000 work in the United Kingdom.

1.3 British Airways is the largest single customer of BAA, the airports operator. In addition to London Heathrow, the airline offers passenger flights from four other UK airports owned and operated by the group: London Gatwick, Aberdeen, Edinburgh and Glasgow; and cargo-only flights from London Stansted. At Heathrow alone, it operates almost 1,950 departures and arrivals each week.

1.4 As a full service airline offering a wide range of ground handling and in-flight services, British Airways has invested many hundreds of millions of pounds in its operations at Heathrow. Of necessity, it is also heavily dependent upon facilities provided and operated by BAA. Heathrow is strategically important to British Airways, and the airline pays around £250 million in airport charges and £90 million in non-regulated charges (utilities costs, check-in, baggage and aircraft ramp facilities etc) at this airport alone each year. Our comments are thus mainly focussed on Heathrow.

2. BAA TODAY

2.1 British Airways and other UK airlines have had to restructure their businesses radically since 2001. Costs have been controlled, efficiencies in operation achieved and product offerings improved as airlines have striven first to survive and then to prosper and grow. BAA has been largely immune to the pressures placed on the wider aviation industry and has not restructured its business to improve performance and efficiencies to the same degree, thanks largely to the regulatory settlement agreed for the fourth quinquennium in 2002.

2.2 During this period, BAA has focussed on return for its shareholders, at the expense of its customers and the wider market of UK Plc.

2.3 The three BAA owned airports—Heathrow, Stansted and Gatwick, account for 91% of all passengers using the London area airports. The BAA owned airports of Aberdeen, Edinburgh and Glasgow account for 85% of all passengers using airports in Scotland. BAA airports account for 63% of all passengers using UK airports.

2.4 Facilities in all areas at Heathrow are inadequate for the number of customers, both airlines and their passengers that it handles today. There has been a lack of strategic investment in the airport for decades, resulting in chronic congestion, insufficient capacity and for British Airways, an inability to grow its business there.

2.5 A severe shortage of runway, airfield and terminal capacity means that in times of disruption, British Airways, as the largest carrier at Heathrow, is more badly affected than other airlines and its ability to recover more limited. The airline and its customers have experienced lengthy delays at check-in, baggage system failures, further delays at security screening, over-crowding in immigration checkpoints areas, and general congestion throughout the airport.

2.6 In part response, BAA has invested £4.3 billion in the new, state-of-the-art Terminal 5 that opens in March 2008. British Airways will be the sole occupier of this new facility, which will be fully operational with the opening of the second satellite in 2010. It will be the first time in British Airways' history that the majority of its long-haul and short-haul flights will be accommodated in the same terminal, a situation its major global competitors have long enjoyed.

2.7 Terminal 5 will be capable of handling 30 million passengers a year, and will relieve terminal congestion and meet future demand for growth. It is also the first airport terminal to be designed for full integration with public transport, with provision for direct rail, underground and bus services.

2.8 Following the opening of Terminal 5 and subsequent redistribution of airport facilities among airlines, BAA intends to construct a new major terminal building, known as Heathrow East, to replace the existing Terminals 1 and 2. This is targeted to be operational in time for the 2012 London Olympic Games.

2.9 Together with the redevelopment of Terminal 3, these new terminal facilities will address some of the operational problems at Heathrow. However, runway and airfield capacity constraints will remain and serious problems will continue to impact on the customer experience and airline operations for many years ahead.

2.10 Even though Heathrow is the world's busiest international airport, a recent survey quoted in the *Daily Telegraph* (30 October 2007) indicated that it was the least favourite airport for passengers. Transfer facilities for passengers and baggage are particularly sub-standard at Heathrow. BAA has allowed this anomalous situation to develop for two main reasons: i) the airports are insulated from the negative effects of poor quality on their business through the service mitigation actions taken by BA and other airlines at our own expense and ii) through BAA's lack of attention to service quality unless specifically instructed to do so by regulators. Even within this regulatory structure, BAA continues to resist improving many dimensions of quality standards that are vital to airline operations and improved customer service for passengers.

2.11 Following the security alert of August 2006, new restrictions came into force, including limits on hand baggage and carriage of liquids. BAA appeared ill prepared to manage these new security restrictions. As a result, significant delays and disruption were experienced at its airports, with Heathrow particularly badly impacted. Heathrow's already stretched baggage handling systems were overwhelmed and customers experienced long delays at the security search checkpoints. This resulted in thousands of passengers missing flights, airlines cancelling services, and an increase in lost baggage. It should also be noted that prior to August 2006, significant security delays were already occurring at both passenger and staff search areas. This suggests that the security infrastructure/resource level was insufficient prior to the alert of August 2006.

2.12 British Airways supports increased usage of public transport for passengers travelling to Heathrow. BAA has invested in the Heathrow Express fast train service from central London, which will also serve Terminal 5 and the Heathrow Connect rail service. British Airways welcomes BAA's initial investment in developing AirTrack, a new rail link from Staines to Heathrow enabling the South and West of England to access the airport by rail. At Gatwick, BAA were involved in the successful lobbying campaign to retain the Gatwick Express, a dedicated rail service from the airport into central London. BAA also plans to invest as a strategic partner in the Crossrail project.

3. CHALLENGES FOR BAA AND ITS CUSTOMERS

3.1 All of BAA's airports in the South East of England are operating at full capacity at peak times of the day. The constraints at Heathrow are particularly severe, as it operates at 98.5% capacity at most times of the day, most days of the year.

3.2 Delays are an increasingly serious problem at Heathrow. Around one-third of Heathrow departures take off more than 15 minutes late. This is the worst record of any airport in the UK, and significantly worse than any other major European hub. Data from Eurocontrol (2006) show that the average delay for departures and arrivals at Heathrow is 40% worse than the German hubs at Frankfurt and Munich. Congested runways mean extra minutes spent stacking in the air, being held at taxiway points on the ground or waiting for stands to clear, all of which increase CO2 emissions. Late inbound aircraft result in late outbound aircraft. With no slack in the system delays can multiply out of control, forcing airlines to cancel services.

3.3 As outlined above, BAA's customers using Heathrow have experienced disruption and inconvenience as a direct consequence of the lack of long-term investment in infrastructure and facilities. Media reports earlier this year highlighted the airport's shortcomings and the belief that Heathrow is losing its prime position as the world's pre-eminent international hub airport.

3.4 This is considered damaging to UK Plc, which also impacts on London's position as a major global business centre and tourism destination. This reflects poorly on the UK overall as a place to do business or to visit for pleasure.

3.5 Planning restrictions make new entry into airport provision highly unlikely. The Eddington report focuses on relieving existing bottlenecks in the transport system as a priority. Any increases in airport capacity are likely therefore to be delivered through more efficient use of existing runways, for example by Mixed Mode operations at Heathrow, in addition to new runways at existing airports.

3.6 The Government's Aviation White Paper in 2003 set out the framework for future airport development in the UK for the next 30 years. The White Paper recognised Heathrow as the international hub airport for the South East of England and ruled out developing Stansted as a second hub. It also gave approval to the development of two new runways in the South East, subject to strict environmental conditions being met, especially at Heathrow.

3.7 BAA owns and operates the two airports granted Government approval to expand runway capacity in the South East. For most of the four years since the White Paper, BAA has focussed almost all its efforts, time and investment on the options for development at Stansted, but relatively little on the options for Heathrow. This imbalance was particularly disappointing for Heathrow's customers, both airlines and passengers, and for the UK generally. However, since the Ferrovial takeover and the closer interest being shown by the Competition Commission, more attention has been focussed by BAA recently on expanding Heathrow runway capacity through support for a third runway. British Airways is encouraged that BAA has started to devote more attention and resources to promoting runway development at Heathrow.

3.8 However, Ferrovial's acquisition of BAA in 2006 was highly geared and this could have significant consequences for airport charges, operations and investment. Such gearing could put airport charges at risk of being called upon to satisfy debts other than those directly incurred in the course of the airport's operations.

3.9 A third runway at Heathrow is vital if it is to continue to be a premier global hub airport. BAA's competitors in Europe and the Middle East continue to invest heavily in airport infrastructure projects. In Europe, Paris Charles de Gaulle and Madrid Barajas airports each have four runways; Amsterdam Schiphol has five; and Frankfurt International Airport has three runways with a fourth planned. Dubai is constructing a new major international hub airport with six runways that will be operational 24 hours a day. The Chinese Government have also committed to building an additional 44 airports by 2010. By contrast, the BAA has never built a single runway in the UK.

3.10 Despite the rapid growth of aviation over the last decade, Heathrow has barely moved in terms of the route network it can offer. Heathrow now offers just two-thirds of the destinations served by Frankfurt and trails Amsterdam and Paris by nearly 25%. And the spectacular growth of Munich means that Heathrow now lies fifth in the European table of airports serving destinations non-stop. In 1990, Heathrow served 227 destinations (compared with 210 at Charles DeGaulle). By 2004 this had fallen to 198 (vs. 224 at Paris) and has continuing to shrink with 180 destinations served in 2007 (223 at Paris). Since 1995, the number of UK regional airports served has also fallen, from 21 to nine. This represents a major threat to Heathrow's status and its ability to compete effectively with other European and global hub airports.

3.11 British Airways recognises that even if the White Paper's conditions are met, a new third runway at Heathrow could not be built until at least 2015, and more probably nearer 2020. As an interim measure, it urges BAA to fully support the option of Mixed Mode operations (ie both runways operating with a mix of take-offs and landings) at the airport to introduce flexibility, operational robustness and delay reduction. It will also allow for additional capacity in due course.

3.12 Mixed Mode operations will require significant input by BAA and other key stakeholders. A long-awaited consultation on Mixed Mode and a third runway at Heathrow is expected shortly, and BAA must engage fully on behalf of all its customers to ensure the future development and growth of the UK's premier hub airport to the benefit of all.

3.13 During the charging period from 2003–08 (Q4), airport charges at Heathrow have risen by an average of 10% each year that equates to a 50% increase for the period.

3.14 The CAA is currently reviewing the Competition Commission's recommendations into its proposed price controls for BAA's Heathrow and Gatwick Airports for the fifth quinquennium. It is likely that further increases over 50% over the Q5 period will be permitted. British Airways believes the regulatory settlement should set a price which fairly balances the interests of BAA and airlines, based on robust and fully tested evidence. It must also deliver cost effective investment where it is necessary and secure or improve operational standards and quality as appropriate. The regulatory settlement must also take into account future developments.

3.15 BAA and the wider UK aviation industry must continue to focus their efforts on addressing the environmental impacts of aviation, both at a local and at an international level. We welcome BAA's participation in industry led initiatives such as the 'Sustainable Aviation' initiative and the newly formed "Flying Matters" coalition.

4. THE FUTURE OF BAA

4.1 Joint ownership by BAA of the three largest airports in the South East has resulted in severe restrictions of competition at the level of provision of airport services: BAA has no incentive to promote vigorous intra-group competition, but instead has sought to manage the airports on a “system basis”. The system of economic regulation in place is not sufficient to overcome these difficulties, and in particular does not provide accurate investment signals.

4.2 BAA’s ownership of Heathrow and its principal competitors in the South East, namely Gatwick and Stansted, blunts its incentive to expand capacity at Heathrow. This situation encourages BAA to secure full capacity utilisation and to develop new capacity at Stansted, in the knowledge that some passenger demand, including future passenger growth, will overflow from Heathrow to Stansted to utilise that spare capacity. Whilst this may be to the benefit of the BAA across its London airports, it works to the detriment of Heathrow as a hub airport and to UK Plc. Major carriers who wish to fly to Heathrow and cannot gain access to the airport will fly to other European hubs rather than to an alternative non-hub airport such as Stansted. At the same time, home based carriers such as British Airways will be unable to grow services to new or existing destinations in line with demand.

4.3 The current regulatory regime imposes no statutory obligation on BAA to seek to ensure all reasonable demands for airport services at its key airports are met, including through investment in new capacity. Instead, BAA is incentivised to undertake investment (much of it pre-funded) that will increase the regulated asset base (RAB) on which its permitted revenues are calculated.

4.4 This encourages the company to invest generally, but does not necessarily ensure the investment projects undertaken are those best suited to meet the demands of airport users. At Heathrow, the regulatory regime has resulted in extensive terminal investment, much of it essential such as Terminal 5, but it has so far failed to bring forward investment to relieve chronic runway and airfield congestion through capacity expansion. (We are encouraged by BAA’s recent focus on Heathrow runway development, but historically their record in promoting such schemes has been poor).

4.5 These factors result in the restriction and distortion of competition at the levels of airline operations and the provision of airport services to airlines in the markets for hub-and-spoke operations at Heathrow and elsewhere in the EU, and in point-to-point operations at airports in the South East and East Anglia.

4.6 To remedy these issues, British Airways believes that this ‘blunting’ of incentives to invest in new runway capacity at Heathrow may ultimately be dealt with by ownership separation of Heathrow and Stansted. However, there would be very considerable timing delays in achieving ownership separation, and thereafter investment incentives, and immediate action needs to be taken and pursued now if a new runway is to be built at Heathrow to meet the Government target of 2015–20.

4.7 Alternatively, if BAA continues to develop its recent strategy aimed at delivering investment in a third runway at Heathrow and as soon as possible, it may satisfy its critics as to the seriousness of its commitment. If this were combined with changes to the regulatory regime to reduce concerns about the distortion of investment incentives, British Airways considers that this would be preferable to ownership separation in remedying the lack of investment, in terms of speed and effectiveness.

4.8 The current regulatory regime has over the years delivered a number of benefits, especially following the quinquennial reviews by the Competition Commission. However, it does not correspond with modern regulatory best practice, in particular its effect in distorting investment incentives.

4.9 British Airways believes the regulatory regime should impose appropriate statutory duties and obligations on the owners and operators of key airports. These may include

- taking all reasonable steps to ensure that current and foreseeable demand from users for airport services at key airports are met
- promoting competition between airports
- meeting service standard requirements

4.10 In addition, there should be a requirement for owners and operators of key airports to be licensed. This provides a means of specifying in greater detail how the statutory duties imposed on both the CAA as regulator and owners and operators as licensees are to be discharged, and permits flexible on-going regulation of the licensees. The licence regime would contain the charge control, but the imposition of statutory duties on the owners and operators will permit greater regulatory oversight and control over investment and its remuneration under the charge control, and permit the current imbalance in favour of BAA to be corrected.

4.11 Other licence provisions could guard against the consequences of Ferrovial’s high gearing of BAA. This could include financial ring-fencing of the BAA’s regulated business and cash lock-up to prevent money being taken out of the business. More generally it could also include appropriate service standard requirements. These could be of fine tuned as required.

4.12 British Airways sees no circumstances in which ownership separation—and the resulting promotion of competition between airports—will obviate the need for on-going economic regulation, including, in particular, a charge control based on the single till and separate price caps for each London airport. At most, competition in consequence of ownership separation may enable a “lighter touch” regime to be put in place.

5. CONCLUSION

5.1 There has been a lack of strategic investment at Heathrow Airport for decades, resulting in chronic congestion, delays, poor customer experience and insufficient capacity to meet new and existing demand.

5.2 Joint ownership by BAA of the three largest airports in the South East has severely restricted competition at the level of provision of airport services including the provision of extra capacity.

5.3 The current regulatory regime no longer corresponds with modern regulatory best practice, in particular its effect in distorting investment incentives. Clearer statutory duties and obligations on the owners and operators of key airports should be imposed by the regulatory regime.

5.4 In addition, there should be a requirement for owners and operators of key airports to be licensed.

5.5 It is essential that further runway capacity be provided at Heathrow as soon as possible to provide much needed additional capacity, reduce delays and enable the airport to retain its position as a leading global hub. In the interim, BAA should fully support the option of “mixed mode” operations in order to reduce delays and improve the overall operational efficiency of the airport.

5.6 Any future ownership separation of BAA airports will not obviate the need for on-going economic regulation, including in particular, a charge control based on the single till and separate price caps for each London airport.

November 2007

Memorandum from the Federation of Tour Operators (FTO) (BAA 17)

This response is prepared on behalf of the Federation of Tour Operators (FTO). FTO is a trade association representing the interests of the major outbound tour operating groups from the UK. It currently has 11 members, as a result of two recent major mergers, who between them sell approximately seventeen million air based packages each year. The majority of leisure travel from the UK departs from the London airports, and as such, FTO members are one of the largest single user groups of the UK airports and in particular the BAA airports.

SUMMARY OF SUBMISSION

- Leisure travel is an essential component of both growth and capacity at BAA airports. We question whether the importance of this market is properly considered by the BAA.
- We believe that insufficient attention has been focussed by the BAA on Gatwick airport, in consequence of which, customers at Gatwick suffer a relatively worse service than many other UK airports.
- We believe that if Gatwick were in separate ownership to the other London airports, investment and operational decisions would have been rather different to those which have been made.
- In contrast, we believe that the BAA monopoly in Scotland has had no apparent adverse consequences.
- We believe that more attention needs to be focussed by the BAA on service delivery to customers at all its London airports.

THE MARKET FOR LEISURE TRAVEL

The leisure market from the UK has been subject to very significant change in recent years. Leisure travel has been growing very significantly, and according to the ONS statistics for overseas travel and tourism for 2006, the outbound market is made up as follows:

	<i>Million</i>
Holiday travel	45.2
Visiting friends and relatives	12.0
Total leisure travel	57.2
Of holidays, inclusive tour passengers	18.9
Total overseas visits by British citizens	69.5

It can therefore be noted that inclusive tours comprise roughly one third of the total number of visits made for leisure purposes. Historically, inclusive tours represented a far higher proportion of leisure traffic. Very significant growth has been experienced in recent years, particularly due to the growth of the no-frills airlines. Whilst the no-frills carriers have given a public message of focussing on regional airports, the following statistics should be noted:

- As a result of the recent acquisition of GB Airways by EasyJet, EasyJet now controls 24% of slots at London Gatwick Airport.
- CAA statistics of airport use comparing 2006 and 2001 show that total airport usage in the UK has grown by 29.8% whereas in the same period, Stansted airport has grown by 73%. As a result, Stansted has moved from fourth to third place in size of airports in the UK.
- In consequence of the above, the three largest UK airports are now Heathrow, Gatwick and Stansted respectively, and in 2006, these three airports represented 53.2% of all passengers travelling through UK airports.

We are concerned that for many years, Government policy has been focussed on the consequences for business travellers of any changes to airport policy, with insufficient focus on the consequences for leisure travellers. This is, in our submission, also reflected to an extent in BAA policies towards airport growth and operation, although we would acknowledge the importance that BAA has given to growing Stansted as a leisure base.

CONSEQUENCE OF OWNERSHIP STRUCTURE

The ownership structure of the BAA, in having regional monopolies both in the South East of England and in Scotland has been, in our submission, to change the behaviour of the BAA to reflect those regional monopolies.

LONDON AIRPORTS

It is the perception of FTO and its members that the shared ownership of Gatwick, Heathrow and Stansted airports, coupled with Government policy leads to those airports being treated almost as a homogeneous whole rather than being seen as constituting separate economic entities, performing different functions in different markets. As an example, when examining the case for expansion of airport capacity in the South East of England, assumptions appear to have been made that it is irrelevant from a customer perspective where additional runways are built, as passengers would find it equally easy to travel to any of the South Eastern airports to undertake their flights. This has resulted in proposals for expansion being driven by the ease of supply rather than demand factors. We recognise the inherent differences of Heathrow compared to Gatwick and Stansted, but it is our submission that the latter two airports are treated as being interchangeable, whereas we believe this is not the case. This position is inherently accepted by the BAA, and as such, we believe that opportunities are not being taken to focus investment to the locations where customers may demand it. BAA investment in recent years has been primarily focussed on the development of Heathrow, and in particular the building of Terminal 5, followed by investment to support the growth of Stansted to ensure its effective utilisation. In consequence, investment in Gatwick has been limited which has led to a devaluation in the quality of service at Gatwick, of which more points will be made below.

We believe fundamentally that if London Gatwick were in separate ownership to either Stansted or Heathrow, the owners of that airport would have made significantly more investment to upgrade the facilities of Gatwick, and would have pushed significantly harder to ensure there was a focus on the need for additional runway capacity at that airport at the earliest opportunity.

We would argue that Gatwick is a local airport as much as a London airport. For passengers travelling from Kent, Sussex and Surrey, Gatwick is their local airport, as it is for many passengers travelling from Hampshire. Current airport expansion policies pre-suppose that at the point at which capacity in Gatwick becomes satiated, passengers will be willing to travel to Stansted in order to undertake their flights. In addition to the road traffic consequences of such a change, we do not believe that customers would willingly accept such a move. The 2003 White Paper on aviation made clear that the case for an additional runway at Gatwick is justified on its own merit. However, since that White Paper, both the Government and the BAA have backed away from any suggestion that consideration of any expansion of runway capacity at Gatwick should be undertaken at any point in the foreseeable future. We would point out that according to data of the Airports Council International, Gatwick is already the worlds busiest single runway, and as such, we believe that there is a strong argument that growth at Gatwick is being constrained by unwillingness to make proper investment decisions.

SCOTTISH AIRPORTS

It is interesting to note that whilst the BAA does have significant influence in owning the three largest airports in Scotland, it does not appear to behave in a monopolistic fashion in relation to those airports, it is the view of FTO that the impacts of that monopoly are relatively small on the overall leisure market.

SERVICE QUALITY

It is the experience of the members of FTO that service quality is lower at the BAA airports than other airports in the UK. A number of FTO members track their customer opinions through customer service questionnaire data against a number of criteria. The mass market tour operators do not in general offer charter programmes from Heathrow, and only minimal numbers from Stansted. Accordingly, the major airport used by charter operators is Gatwick, and it is apparent from customer questionnaire returns that the service experience at London Gatwick is significantly worse than other UK airports. Whilst there are a variety of causes for this, it is our opinion that a significant contributing factor is the age and quality of the infrastructure at Gatwick as a result of relative under investment over a prolonged period.

We believe this situation is compounded by both at Gatwick and at Heathrow by incredibly high airport utilisation, which has the effect of putting a strain on all facilities at these airports to the detriment of customer service.

We would acknowledge the work undertaken by the BAA over the past year at Gatwick in particular to attempt to improve the customer experience but still believe that standards are unacceptable, particularly of the supposed flagship airports in the UK, and certainly the two largest airports in the UK.

We hope this information assists the Transport Select Committee. FTO and its members would be happy to give any further assistance that the Committee may require.

November 2007

Memorandum from the Heathrow Airline Operators Committee (“AOC”) (BAA 18)

EXECUTIVE SUMMARY

1.1 The AOC represents the interests of 90 airlines operating at Heathrow. Some of the airlines are part of global commercial alliances. Each of the terminals at Heathrow (“LHR”) has an AOC chairperson (elected) and meetings take place every month. The AOC terminals’ chairpersons attend the AOC Executive which is the final decision making body for all operational matters which it is involved with. The Executive has a chairperson (elected) and a general secretary (appointed). The principle objective of the AOC is to provide an effective interface between the airline community and BAA, Government Departments and Agencies and other authorities and to represent the interests of the travelling public as an adjunct to the global airport experience.

1.2 The lack of competitive incentive brought about by BAA’s regulated monopoly imposes a higher level of costs on the airlines operating at Heathrow than would be experienced at an open market airport.

1.3 Constructive Engagement (“CE”) has provided a significant step forward in regard to the consultative process between the airline community and BAA and promises greater transparency of costs in certain areas in the future.

1.4 In order to maintain competitive pricing, along with many other industries, airlines have adopted benchmarking of self- provided services. Where outsourcing has proved to lower costs while maintaining levels of service this has grasped. BAA appears to be reluctant to take up this challenge.

1.5 Competitive pressures have forced the airline industry into improved cost effectiveness through increased productivity. This has not been replicated by the BAA.

1.6 Traffic forecasts condition most of the airport charges and the airlines are in conflict with BAA on their view of the future.

1.7 A limited range of service quality measures have been seen to work as an incentive to improve BAA performance. The AOC seek to extend the range of measures and associated targets.

1.8 Capital expenditure could be reduced by implementing industry standards for “risk” and more effective management and governance.

1.9 Despite CE recommendations for the implementation of a CIP “Tracking” process there remains considerable opaqueness regarding capital expenditure. “Triggers” are to be applied to manage the progressive capital funding of programmes against specific milestones.

SUBMISSION BY THE HEATHROW AIRLINE OPERATORS COMMITTEE (“AOC”)

1. *Background*

1.1 The AOC are pleased to be able to submit evidence to the Transport Select Committee. The AOC would also welcome the opportunity to present to the Committee and to submit oral evidence.

1.2 LHR as a commercial and operating environment is complex. Slots are highly prized and desired—yet one of the world’s busiest airports is crammed into a relatively small geographical space—this creates an ongoing operational challenge.

1.3 The cost of operating and the quality of service to be purchased for that cost are constant dynamics—which are at the forefront of the airlines attention. The fact that a high proportion of that cost is derived from a monopoly supplier represents a key factor. The airlines strive to influence and work with BAA with the aspiration to contain and reduce such costs. The influence of the Regulator in counter balancing the loss of leverage of competition and ensuring an environment which supports the passenger’s interest and modifies the influence of a major supplier is key going forward.

1.4 The “Single Till” is an important adjunct to this regime—creating a valuable contribution from non-airline interests who benefit greatly from airport and airline operations. The AOC support this financial arrangement and would not seek to see it changed.

1.5 For many years the facilities and services at LHR, that makes up a significant proportion of airport charges, have been inadequate due to under-investment. At the same time the airlines have been faced with ever increasing airport charges. Although there has been a large investment during the past five year period (“Q4”), in the main this was to build and commission Terminal 5. The Capital Investment Plan (“CIP”) for the next five years (“Q5”), of the order of £3,500 million, is primarily intended to provide for the first phase of Heathrow Terminal East (“HET”) and the building of Satellite C, Terminal 5. Other construction projects and refurbishment work are included in a somewhat overdue attempt to achieve a degree of commercial equivalence across LHR. It should also be noted that a number of significant ‘overlay’ projects are currently being discussed and are not included in the Q5 CIP. For example mixed mode and runway 3 will give rise to a capital requirement in excess of £800 million. In the eyes of the airline community the present unacceptable service levels at LHR are the result of under-investment in the past. The AOC believe that without the leverage of competition BAA has used its monopoly to increase share holder value and provide additional benefits for its employees at the expense of the airlines who have been forced to pay premium charges for unsatisfactory facilities and services. It is also pertinent to note that no known efficiency benefits achieved by BAA, if there have been any, have been shared with airport users.

1.6 Most airlines have, for many years, been forced to evaluate and implement operating efficiencies in order to remain competitive in an aggressive market. Inflation and cost increases have, in the main, been self financed through improvements in working methods and operating procedures and reduction in other costs. Put simply commercial airlines have had to improve productivity and reduce costs in the same adverse industrial climate as is constantly sited as a major impediment by BAA.

2. *Constructive Engagement*

2.1 The AOC has, together with BAA, embraced the CAA initiative of Constructive Engagement (“CE”). CE has, in the main been a significant step forward and has facilitated an objective and meaningful process for consultation between the airline community and BAA. It has also lead to a greater understanding and cohesion between BAA and the airline community. The AOC are of the view that CE must continue into Q5, and beyond, if ongoing efficiencies are to be achieved and made transparent.

2.2 *Non-regulated Charges*

2.2.1 Non-regulated charges are continuing to be addressed within the Specified Activities Permanent Working Group. However, although visible consultation, governance and monitoring are of a much higher order—the pressure on annual price increases remains.

2.2.2 Whilst some of this increase in charges is commodity driven—there has been very little headway into the reduction of cost by greater efficiency and wider use of sub-contracting. The AOC has recently undertaken a benchmarking study with commercial security companies. The BAA security services benchmarked included Central Search and Control Posts. The study identified that potential savings of between 25% and 35% were possible in terms of operating cost. Reduction in costs is fundamental going forward and impediments which, by proven track record, have been over-come by the airlines should not be offered as mitigation by BAA.

2.2.3 As Q5 progresses—it will be essential to ensure that such charges remain visible and only remunerate incurred costs.

2.3 Operating Costs (Opex)

2.3.1 CE has provided the opportunity for the airlines to inquire, albeit at a macro level, into specific areas of significant BAA Opex. The airlines have sought to probe the comparable efficiency of employee contracts of employment, working methods and staff rosters. When compared with the efficiencies that the airline industry has had to implement to remain competitive, there appears to be potential for significant cost reductions in designated BAA operational areas. The Airlines have managed to embrace such efficiencies in the same adverse industrial climate. Moreover in the airline case, the strict contracts and service level agreements between customer and provider have ensured no diminution of passenger service whilst reducing cost and increasing efficiency.

2.3.2 The airlines are concerned that the annual increase in RPI may be considered as justification for increases in Opex costs. The airline industry, in the main, has over a period of time been forced to innovate and implement efficiencies leading to reductions in costs in order to self finance RPI increases and rewards to staff. The airlines would like to see a greater determination on the part of BAA to implement efficiencies comparable to those that the airlines have found it necessary to adopt.

2.4 Traffic Forecasts

2.4.1 Reduced Traffic Forecasts—the proposed (reduced) levels, by BAA have been consistently contested by the Airline Community. It is thought unlikely that this issue will be resolved within the confines of CE. They are by any “yard-stick”, conservative. This is particularly significant in regard to transfer volumes. The airline community is in conflict with BAA on this issue.

2.4.2 The hopes for intra terminal synergies will not be accomplished fully until after mid 2012 (within the final year of Q5). Even beyond that point some of the greater airline transfer pairings will remain at the widest inter terminal distances. Thus an “Economic Cycle” increase in transfer numbers would be a double blow—viz: ahead of forecast; a disadvantageous operating environment.

2.4.3 It should be noted that it took prompting from the CAA for BAA to provide their charges forecasts in detail. The AOC were not content that the information had to be restricted because of the Ferrovial take-over.

2.5 Service Quality

2.5.1 There has been considerable dialogue between the parties and this is still ongoing.

2.5.2 The airlines have suggested that the amount of rebate at risk be increased from 3% to 9% of airport charges. This is not because the amount of money is important—service to the passenger is the paramount factor. It is likely that the number of service quality measures will increase over those applicable in Q4. The airlines are advocating that the amount of money at risk is increased as follows: 4% operational, 2% control posts, 1% QSM, 2% airport/aerodrome congestion term. The airlines are also recommending that certain of the targets be increased to support the elements of quality important to the passenger.

2.5.3 The AOC believes that the original concept, which as the result of a Competition Commission public interest finding, was one that under-pins the provision of good customer service for the benefit of the passenger.

2.5.4 It has been clearly demonstrated that Airport Operators can improve service quality when incentivised by such a mechanism. The AOC therefore, supports the retention of all existing metrics and recommends adding to these.

2.5.5 Where improvement requires additional man-power as opposed to infra-structural investment—this must be at a much lesser cost base than that of today.

2.5.6 The AOC are desirous to see improved metrics in on pier service and (direct) security queuing. Additional metrics to cover:

- Transfer Security Queuing—(with the same metric as direct)
- Control Posts (Landside/Airside Access)
- Provision of Stand Entry Guidance

2.5.7 Without the safeguard of these metrics and the continued interest of the Regulator—the balance of influence will shift from the interest of the passenger to the interest of the constructor and ambitions of BAA.

2.5.8 The AOC is disappointed that at LHR, the world’s busiest International airport, standards continue to deteriorate and BAA seems only to address quality when required by the regulator.

2.6 Capital Expenditure Efficiency

2.6.1 The AOC believe that effective levels of “Risk” and its management hold the potential to significantly reduce the CIP and thereby airport charges. Transparency with regard to the levels of risk is essential and the airlines now await proposals on how risk is to be managed going forward.

2.6.2 It is essential that airline representatives be involved at key points in major capital projects. Their involvement at designated “Gateways”: decision points in a process for controlling and managing capital projects; would add to improved functionality and have the potential to reduce expensive change orders that can arise at a later date when projects near completion. Put simply the key stages of funding need to be matched to the applicable project milestones.

2.7 Capital Investment Programme—“Tracker Programme”/“Triggers”

2.7.1 A BAA programme known as a “Tracker” must be developed and implemented to ensure transparency with capital spends. In the past it has not been possible for the airline community to see the total spend on any capital project or where overspend or underspend has occurred. The tracker has been called for by the airline community to ensure transparency of expenditure. The AOC believe this is a key control measure going forward.

2.7.2 The Competition Commission (“CC”) has proposed that 75/80% of the Q5 capex programme be subject to investment “Triggers”. The airline community sees this as an essential incentive on BAA. Milestones in connection with proposed triggers are being discussed and must be incorporated in the Q5 settlement. The CC have recommended that the CAA should arbitrate if BAA and the airlines fail to reach agreement on the triggers to be applied or on the detailed specification of each trigger; and that it should continue to be involved in the event of any disagreement of whether the agreed triggers are subsequently meet.

3. Airport Charges

3.1 The AOC are disappointed that whatever the capped level of charges set, BAA always charge up to it. The annual round of airport charges negotiations are nothing more than confirmation by BAA of the capped level. Once maximum charges have been set by the regulator they become set in stone for the five year period.

3.2 Airport regulation also requires that airlines pay up-front for facilities even though the facilities may not come on line until well into the five year period. This results in airlines paying enhanced charges when facilities may well be sub- standard.

November 2007

Memorandum from Unite (BAA 19)

1. INTRODUCTION

1.1 This evidence is submitted by Unite the Union, the UK’s largest trade union with 2 million members across the private and public sectors. The union’s members work in a range of industries including manufacturing, financial services, print, media, construction, transport and local government, education, health and not for profit sectors. The Civil Air Transport (CAT) Trade Group of Unite, is the largest trade union representing employees employed in the United Kingdom (UK) aviation industry. The CAT Trade Group represents workers in all areas of civil aviation except for flight deck and air traffic management.

1.2 The union’s current membership in our CAT Trade Group is over 50,000, of which over 6,200 are employed within the seven BAA airports in the UK. In addition, there are some 1,200 members of the Amicus Section of Unite working in the BAA airports. Other members of Unite are working for companies who supply services in the airports, or are working directly for airline companies.

1.3 The union has a unique overview of the issues facing the BAA, rather than the more partial views of the company or its customers, each of whom will have their own agenda.

1.4 We recognise that the company is facing a number of unique challenges in addition to those faced by the aviation sector as a whole, and we welcome the Transport Committee’s inquiry to find out how the company, the government and other stakeholders will respond to the current situation.

2. OWNERSHIP OF THE MAIN LONDON AIRPORTS

2.1 For the CAT Section of Unite, the most serious challenge is the perennial competition issues in regard to BAA, which is its ownership of the three main London airports.

2.2 The origins of this debate go back to the privatisation of BAA and the policy set out in the Airports White Paper 1985 paragraph 9.9 “One option considered was to break up BAA—although this would have reduced BAA’s dominance this option was found not to bring substantial advantages and to have some important disadvantages”. A similar comment was also made about BAAs Scottish Airports in paragraph 9.11.

2.3 Both the Monopolies and Mergers Commission and its successor the Competition Commission (CC) have both investigated this issue. The CC report on price controls in 2002 paragraph 2.18 states: “. . . although acknowledging that the three airports would only compete with each other to a certain extent since they were not effective substitutes for each other/and hence would still need to be regulated.” (This was also acknowledged by other airlines in favour of separation.) . . . On the other hand, some parties argued against “enforced competition”. BA suggested separation was irrelevant to solving the problems it had identified. BAA said the question of ownership had been reviewed many times by third parties who had all concluded in favour of the current system framework.

2.4 The definition of the consumer in this instance is important. Is the customer, the airline, the airline user, or both? Clearly the different answers will result in different outcomes.

2.5 More recently your own report³⁴ unfortunately stated that: “we see no reason to change the view of our predecessor Committees that BAA should be broken up (p53)”.

2.6 As previously stated some of the airlines would argue that the BAA operates a monopoly in regard to the London airports, and therefore this monopoly should be broken up. They believe that the break-up of the BAA monopoly would then result in increased competition between the London airports. Therefore they assume there would be a reduction in the price of the charges they pay for using the London airports facilities.

2.7 This we think is a simplistic and naive argument.

2.8 Firstly, in economic terms a monopoly is only as strong as its nearest substitute. As the OFT itself points out: “. . . Amongst airports serving London, BAA’s share has been stable (92% in 2005; 95% 1990) (OFT 2006: 2). While it is true that the BAA has a local oligopoly for airports serving London, it does not have a wider monopoly and it is not the most expensive of the four FLAP³⁵ airports.

2.9 But even with this price advantage over the other FLAP airports Heathrow airport is losing ground in Europe measured by the size of its global route network and is set to be overtaken by Munich, Germany’s second-largest airport after Frankfurt. Future Heathrow, the aviation lobbying group, has said that Heathrow would be overtaken by Munich by the number of destinations offered putting the UK airport in fifth position with 178 routes compared with 179 at Munich, 203 at Amsterdam Schiphol, 220 at Paris Charles de Gaulle and 233 at Frankfurt—See Done 2006.

TABLE 2.1

<i>Airport</i>	<i>Index</i>	<i>Ranking</i>
Paris—CDG	77	7
Frankfurt	72	9
Amsterdam	69	12
London—LHR	58	27
London—LGW	35	44

Source: TRL Airport Charges Index 2005

2.10 Also competition is coming from outside of Europe for example Dubai is increasing becoming a competitor to Heathrow.

2.11 Secondly these London airports operate in distinctly different segments of the market. Heathrow is primarily a business, international and interline airport. Gatwick is servicing the holiday, European, and South of London and low cost market, while Stansted is a low-cost airline airport. This begs the question if they operate in distinct segments of the market how could breaking them up increase competition

2.12 Thirdly, those airlines arguing for the split-up of BAAs London airports assume that the BAA is overcharging them, and as a result of the introduction of competition will result in a reduction of their charges. But a monopoly normally only has control over the price or the output. In the case of the BAA in regard to the London airports it has neither.

2.13 This is because these airports are regulated and their prices set by the Civil Aviation Authority (CAA) and the CC. It is difficult to see how overpricing could happen, unless of course there was a failure in the regulatory process which is outside the control of the BAA! Also the Government through the CAA and its various aviations policies controls the number of airplanes using the London airports.

³⁴ Passengers’ Experiences of Air Travel Eighth Report of Session 2006–07 Volume I Report, together with formal minutes.

³⁵ The FLAP airports are: Frankfurt; London; Amsterdam; and Paris.

2.14 The opening of up London's airports to competition is likely to make them more valuable, especially if price regulation is partially or wholly lifted in exchange. Indeed, we find it difficult to see how the current price regulation could be maintained if BAA ownership of the main London airports was broken up. By implication the breaking up of the BAAs ownership would result in competition between these airports, and it would be difficult to see in this situation how an economic regulatory role could be maintain at its present level. Indeed, it is quite likely that airport landing charges would increase as a result of removing the regulatory environment. This was recognised by the MMC in its 1996 report on price controls paragraph 2.28. "Among the attractions if Gatwick were to be separately owned and managed is that it might make greater attempts to attract traffic from Heathrow and stimulate Heathrow to improve its performance in certain respects. Unless Gatwick becomes a hub airport or Heathrow becomes a point to point airport, it is doubtful such competition could happen. On the other hand, given the unique advantages of Heathrow and the higher profitability of airline operation there, such competition might not be effective; separate regulation of the airports would be required which could result in charges at the two airports being more closely related to cost than at present, ie higher charges at Gatwick and lower charges at Heathrow, which would be undesirable given the greater demand to use Heathrow and the greater congestion there . . ."

2.15 Another issues is that counter intuitively the BAA London Airports could be worth more individually than all three together. For example, Gatwick Airport could have a greater standalone value if it were priced on the same multiple as other unregulated airports, such as the proposed sale of City Airport and other privatised airport selling for about 15–16 times earnings before interest depreciation and amortisation (ebitda). "That was the level finally reached in 2006 hectic bidding for BAA . . ." (Done July 2006). In the financial year 2004–05 Gatwick Airports ebitda was £172.1 million resulting in a market value of £2.581 billion. This market value would mean it would have to charge higher rates for its services to get a market return for its new shareholders than under the present regulated system. It has been estimated that that "Free of the regulators, Gatwick could be worth towards £1 billion more than its Rab [regulated asset base] value . . ." (Osborne 2006). The 2006 estimated Rab for Gatwick is £1.6 billion.

2.16 Even in the current global economic situation Unite believes that at this market price BAA would have little or no problems selling Gatwick Airport. Many private equity firms, infrastructure funds and other institutional investors, especially pension funds would still be interested in purchasing Gatwick.

2.17 Therefore the question has to asked would breaking up these airports actually result in a misallocation of resources? This then raises another unanswered economic question, has a proper cost benefit analysis of the break-up of the London airports been undertaken? If not how can we judge if the sale of one or more of these airports would benefit the consumer.

2.18 Also the Committee has to recognise that due to the existence of high "sunk costs" any airport market is unlikely to be a "contestable market". "Contestability theory holds that, in a perfectly contestable market, the threat of competition by potential entrants can discipline firms to price their products in a socially efficient manner that yields only normal returns" (Cains and Mahabir 1988: 269). These high sunk costs already create a barrier to entry, and if the planned expansion anticipated by the Aviation White paper goes forward, even higher sunk costs will exist.

2.19 Another barrier to entry, which the OFT recognises is the long-term planning restriction on increasing the capacity at an existing airport, let alone the almost impossible task of establishing a new airport in the London area. It will be difficult enough to increase the existing capacity of these airports in line with the Governments Aviation White Paper targets. These targets have been set by government to protect the UKs competitive position in the global economy.

2.20 Therefore Unite believes that any attempt of increasing competition between the London airports is not likely to be achieved by the divestment of one of the BAAs London Airports. In fact as a result of competition prices could actually increase.

2.21 Unite believe that the existing regulatory environment creates a positive environment that it provides certainty for BAA. Anyone listening or viewing financial programmes cannot be unaware of the countless times various commentators say that what the market wants is certainty. The stable economic environment allows the BAA to raise funding more easily on the capital markets and probably at a more advantageous rate.

2.22 According to its 2004–05 Annual Report BAA had a long-term credit rating of A1 + /A. However, in June this year Standard & Poor's, the US credit rating agency, said it had lowered its rating for BAA by two notches from A to BBB +, because the recommended bid meant that the risk of BAA taking on much more debt had been "greatly increased" (Done July 2004).

2.23 Gross debt at 31 March 2006 was £6,239 million (£4,274 million), reflecting the recent multi-tranche £1,940 million bond issue, consisting of €1 billion 3.875% bonds due 2012, €750 million 4.5% bonds due 2018 and £750 million 5.125% bonds due 2023.

3. EXTERNAL PRESSURES

3.1 Nobody could have failed to notice the bad publicity that BAA has received over the last 12 months or more. But many of the events which resulted in the bad publicity are outside of the control of BAA.

3.2 The pressures placed on security since 10 August 2006 has resulted in BAA finding it difficult and time-consuming to recruit the additional 500 or so staff it needed for its increased security responsibilities imposed on them by the Government. The criminal records, employment and counterterrorism checks take a long time, and these checks plus proficiency tests weeded out a large proportion of applicants.

3.3 The requirement for physical checks on a percentage of passengers meant that more female security guards were needed than before. BAA was finding it difficult to recruit them because of a lack of crèches and other family-friendly policies. There had to be security staff at work from 3 or 4 am in order to meet the business needs of the airport, which also affected recruitment as many people did not want to start so early.

3.4 These increased security and employment related issues have resulted in a difficult industrial relations atmosphere at some of the airports. For example the staff at Heathrow are having to working in intolerable conditions. They require plenty of drinking water in the security areas and this is not being delivered: the working areas are not sufficiently clean and the air-conditioning caused difficulties.

3.5 Heathrow is a difficult place to work because of the building work taking place and the pressure of the security requirements. There is increased evidence of physical and verbal abuse of staff because of the pressurised environment for passengers and the different security regimes operating in the UK from those in other countries. There are many other employment opportunities in the area around Heathrow, which made it difficult to attract people to work at the airport.

3.6 “For BAA, the activities that generate customer satisfaction—providing seats, enough security guards, clean toilets and travelators that work—are a cost, not a source of revenue. Profits are derived from landing charges, parking fees and selling Burberry scarves and smoked salmon. Only a basic knowledge of economics is needed to explain why there are longer queues at the X-ray machines than for the scarves and the salmon”.³⁶

3.7 As this paper indicated earlier the problems at Heathrow and other BAA airports are often the result of other companies actions. Widespread complaints about “Heathrow hassle” were fuelled by official figures released this month that rated British Airways as the worst performer among leading European airlines for both flight delays and misplaced baggage over the busy summer period.

3.8 According to data published by the Association of European Airlines, covering July to September this year, BA ranked 24th among the 25 airlines which disclosed statistics for the number of delayed bags per 1,000 passengers. Only TAP Air Portugal had a worse record—although several carriers, including Virgin Atlantic, BMI British Midland and Aer Lingus do not disclose baggage figures.

3.9 BA, whose other main airport is Gatwick, was 26th of 28 carriers for punctuality, measured by delays in flight arrivals, ahead only of Spanair and TAP.

3.10 Among the big European network carriers BA’s punctuality performance also remains dire, with KLM ranking second, measured by delays in flight arrivals, Lufthansa sixth, Air France eighth and Iberia 15th.

3.11 Willie Walsh, BA chief executive, has warned again that the airline’s punctuality and baggage performance remained a challenge at Heathrow, where facilities were “old and over-stretched”. The airport was designed for 45 million passengers a year but is currently looking after 67 million.

3.12 During the third quarter this year BA’s performance was hit in particular by the temporary closure of T4 for several hours in early July 2007 as a result of a security alert, and by failures of the baggage systems resulting in severe congestion. During July the airport’s operations were also hit by the severe thunderstorms and torrential rain, which caused serious flooding across southern England.

3.13 Users have warned that Heathrow’s poor performance posed a threat to the status of London as one of the world’s leading financial centres. The City of London Corporation said that the AEA figures were “disappointing”, but BA was working hard to improve its baggage handling arrangements, primarily at Heathrow. “The airport is at the centre of the City’s success as the world’s leading international financial and business centre. Ease of access is pivotal to the City’s ability to thrive,” it said. “The biggest cause of BA’s problems with punctuality is over-congestion at Heathrow. The City is working closely with the government, airlines and BAA to find the best solutions to this.”

4. CONCLUSIONS

4.1 Unite believes that the differences in staff attitudes and morale at the different BAA airports should be attributed to the physical working conditions rather than to the local management. Also any break-up of the London airports would have a destabilising and demotivational affect on the moral of the staff involved which could have serious implications for customer service levels for the new owner(s).

November 2007

³⁶ “Heathrow’s problems result from a flawed concept” by John Kay *Financial Times*: June 26 2007.

Memorandum from the Board of Airline Representatives in the UK (BAR UK) and the International Air Transport Association (IATA) (BAA 20)

OPENING STATEMENT

This response is submitted by Board of Airline Representatives in the UK (BAR UK) Ltd, and is also made on behalf of IATA (International Air Transport Association).

BACKGROUND

BAR UK Ltd is the airline industry association that represents scheduled airlines in the United Kingdom.

BAR UK represents 95 airlines (list attached) in their dealings with the UK Government and its departments, regulators, airport operators and other key external stakeholders.

IATA is the global airline industry association, and represents 240+ airlines worldwide.

In any matter related to BAA, there is a natural focus on Heathrow, to which the great majority of our members operate. However, several of them operate to some or all of the other airports, as shown in the table below.

BAA AIRPORTS

BAA OWNS AND OPERATES SEVEN AIRPORTS IN THE UK. THEY ARE:

<i>England</i>	<i>BAR UK/IATA members</i>	<i>Scotland</i>	<i>BAR UK/IATA members</i>
London Gatwick	30	Aberdeen	5
London Heathrow	74	Edinburgh	9
London Stansted	6	Glasgow	9
Southampton	1		

Should BAR UK be asked to present itself to the Committee, then it should be noted that IATA would wish to appear at the same time.

CALL FOR EVIDENCE—THE ISSUES

The scope of the Committee's enquiry is wide.

Whilst it would be easy to concentrate on the adverse high profile that airports have "enjoyed" in recent times, the Committee's attention is drawn to the list below as being of considerable strategic and/or everyday interest to airlines and their customers in their dealings with BAA.

1. Costs at Regulated airports (Gatwick and Heathrow)
2. Market power / monopoly situation
3. Airport capacity versus market demands
4. Ease of access to airports
5. Security search controls eg
 - a. Number of passenger search lanes
 - b. Number of staff search lanes
 - c. Number of search lanes actually in use
 - d. Number of airfield control posts, and efficiency of processing (road traffic entering "airside" eg crew buses, catering trucks etc)
 - e. Adequacy of staffing
6. Service quality issues eg
 - a. Lifts out of order
 - b. escalators out of order
 - c. airbridges out of order

THE EVIDENCE

1. *Costs at Regulated airports (Gatwick and Heathrow)*

The CAA is the regulator for Gatwick and Heathrow, and sets a maximum “cap” on charges in five-yearly periods (quinquennia). The charges for the next quinquennium (2008–13) are currently in the process of being arranged.

Whatever the capped level that is set, BAA always charges up to it. The annual pricing “discussions” are not an opportunity to negotiate a lower level, merely one to listen to why BAA are so doing.

In practice therefore, once the maximum charges have been determined by the regulator, they are the ones that are set in stone for the next five years.

Airlines are also prepaying for facilities that are often not operational for a number of years. In fact, it means operating flights at a premium cost at the very time when the operational environment is degraded, a situation possibly unique to airport regulation.

For example, whereas a hotel may reduce its room rates during construction, airlines are actually charged more!

The opening of Heathrow’s Terminal 5, in March 2008, activates a four-year long programme of airlines relocating between terminals, at the same time as they are redeveloped, and the taxiway system re-configured.

Airlines will be paying premium prices at a time when operational capacity, already stretched, will be at maximum with little or no resilience in the system.

2. *Market power/monopoly situation*

The airline community is exercised by the market power and monopoly situation that BAA has.

Those concerns are best summarised in the response to the Competition Commission, which was also made on behalf of BAR UK, made by the International Air Transport Association (IATA), as per the following key comments.

“Busy or constrained airports are natural monopolies of essential facilities and services for the airlines. Market forces do not necessarily or adequately discipline such monopolies, particularly at these airports.

“The economic regulation of the three London Airports in particular has failed to protect the interests of the consumers and is clearly balanced in favour of the airports and their shareholders.

“We believe this market study is necessary and timely against the background of:

- BAA’s 92% passenger market share in SE England and 86% share in Scotland.
- While airlines are continuously reducing costs in line with consumer demand, the airports are not adequately contributing within the value chain to the promotion of competitive markets that benefit air travellers.

“In our view increased competition will yield significant benefits in terms of timely and adequate investment in airports and a better value service to the travelling public.

We believe a reference should be made to the CC for an in-depth investigation of the extent to which the BAA is abusing its market strength and position, particularly in SE England

“We look forward to the CC undertaking a comprehensive review of these important issues, on which we will of course be very pleased to provide any further information on request and attend a Hearing if this is considered helpful.”

3. *Airport capacity versus market demands*

There is no doubt that both Heathrow is operating to maximum capacity, and that Gatwick often does so. The market demand for these two airports remains consistently high, and there are few signs that other London airports, whatever their ownership, offer sustainable alternatives.

In both cases, the core reason is lack of runway capacity.

However, as BAA owns all three major London airports, the incentive to develop them independently of each other does not exist.

For example, there is a legal restraint on a second runway at Gatwick until 2019. It is perceived that the lack of a challenge by BAA to that restraint is due to the fact that they would rather see a third runway at Heathrow before a second one at Gatwick. The independent ownership of these airports would quite possibly have seen a different turn of events.

The same perception may well apply in respect of building a second runway at Stansted. A poll amongst our membership indicated that, if Heathrow was constrained, then their distinct preference is for additional capacity at Gatwick, not Stansted. Again, there has not been any challenge to the constraint of 2019.

Accepting the current situation, the airline community at Heathrow is at one with BAA on the need to expand this airport, subject to the environmental measures that apply in respect of emissions and noise.

That expansion can take place in a couple of ways: the introduction of mixed mode operations on the current two-runway facility, and the construction of a third runway.

An additional terminal would be required to handle the additional passenger traffic created by the new runway.

The Department of Transport is expected to issue a consultation document regarding such measures in the near future, and BAR UK will provide a full response to it.

NB As very few BAR UK members operate to Stansted, no view was expressed in response to the formal concerning the construction of a second runway there except to say that it must not be subsidised by charges at other BAA airports.

4. *Ease of access to airports*

The projected growths at Heathrow and Gatwick cannot be sustained if passenger transport facilities are not properly developed in tandem with them.

Heathrow:

BAR UK supports BAA in the development of the discussed AirTrack rail line to Heathrow from Staines, and the Cross Rail project through London from east to west.

Gatwick:

The likely demise of the Gatwick Express was announced in October 2004. BAR UK was a leading proponent for the retention of this excellent, and vital, rail service, and supported BAA for this same cause.

It was only in March of this year, two and a half years later, that the service was formally saved.

As with Heathrow, a good public transport service is absolutely vital in supporting airport growths.

Other BAA airports:

Stansted has its own station directly below the terminal building, and Southampton Airport has a station immediately adjacent to the terminal.

The Scottish Airports, Aberdeen, Edinburgh and Glasgow are not currently linked by direct rail services, though it is understood that discussions may be taking place to explore the possibility of doing so at one or more of these airports.

5. *Security search controls:*

The aviation security regime was suddenly made even stricter in August 2006, the requirements for which placed considerable burdens on airlines and airport operators. The regime has been subject to revision since then, often adding more burdens to all concerned.

Passenger queues have been well-documented; what is less evident in the public eye are the stresses and strains placed on crews and traffic who need to move into the secure "airside" areas of airports.

This has led to considerable delays at staff and road traffic control posts and, in a number of cases, delayed flights.

The concern of the airline community is that, in the considerable length of time that has elapsed since August 2006, BAA has been much slower than expected in providing the required resources to handle these additional pressures.

Additional security channels have been physically provided but, in many cases, have remained unused due to lack of staff. The lack of resources has contributed directly to the slowness in the lifting of the single cabin bag restriction that applies to travellers leaving the UK.

It is understood that the Heathrow Airline Operators' Committee (AOC) will be responding directly to the Transport Committee, and that their evidence will provide more details on this vital matter. BAR UK will support their comments.

6. *Service quality issues*

The Heathrow AOC response will also address these issues, which include the serviceability of travelators, lifts, airbridges and other key service facilities.

Again, BAR UK will support their comments.

In closing, BAR UK and IATA will be pleased to provide any further information that the Transport Committee may seek, or to expand upon the views expressed herein.
List of Member Airlines shown on following page.

November 2007

MEMBERS

Adria Airways	Gulf Air
Aeroflot Russian International	Iberia
Aerolineas Argentinas	Icelandair
Air Astana	Iran Air
Air Canada	Japan Airlines
Air China	JAT Airways
Air Europa	Jet Airways
Air France	Kenya Airways
Air India	KLM Cityhopper *
Air Malta	KLM—Royal Dutch Airlines
Air Mauritius	Korean Air
Air Namibia	Kuwait Airways
Air New Zealand	LOT Polish Airlines
Air Seychelles	Lufthansa
Air Transat	Malaysia Airlines
Air Zimbabwe	Malev Hungarian Airlines
Alitalia	Meridiana
Alitalia Express *	Middle East Airlines
All Nippon Airways	Northwest Airlines
American Airlines	Oasis Hong Kong Airlines
Asiana Airlines	Olympic Airlines
Austrian Airlines	Pakistan International
Austrian Arrows *	Qantas
Belavia Belarusian Airlines	Qatar Airways
Biman Bangladesh	Royal Air MAroc
BMI	Royal Brunei Airlines
BMI Regional *	Royal Jordanian Airlines
British Airways	SAS
Brussels Airlines	Saudi Arabian Airlines
Caribbean Airlines	Silverjet
Cathay Pacific Airways	Singapore Airlines
China Airlines	South African Airways
China Eastern Airlines	Srilankan Airlines
Cityjet *	Swiss International Air Lines
Continental Airlines	Syrian Arab Airlines
Croatia Airlines	TAP—Air Portugal
CSA—Czech Airlines	Tarom
Cyprus Airways	Thai Airways
Delta Air Lines	Tunis Air
Egyptair	Turkish Airlines
El Al Israel Airlines	Turkmenistan Airlines
Emirates	United Airlines
Estonian Air	US Airways
Ethiopian Airlines	Vietnam Airlines
Etihad Airways	Virgin Atlantic Airways
EVA Airways	VLM Airlines
Finnair	Yemen Airways
GB Airways *	

* Affiliate members.

Memorandum from the Edinburgh Chamber of Commerce and the City of Edinburgh Council (BAA 21)

While being well connected is extremely important to the efficient functioning of any economy, Scotland's position on the periphery of Northern Europe makes good connections not just important but essential. For these reasons, the current uncertainty as to the future of the UK's main airport operator, BAA is of utmost concern to Edinburgh's business and political leaders.

Edinburgh airport performs a vitally important strategic role as a key gateway to the Edinburgh city region for both tourists and business travellers. Any future constraints on the growth of services to and from Edinburgh airport, either in frequency or scope or new limitations placed on future investment in airport facilities, would seriously damage the competitive position of the city relative to other cities across Europe and beyond. Given Edinburgh's role as a primary engine of Scottish economic growth, any constraints on the growth of services to and from Edinburgh airport would therefore also have serious negative consequences for the national economy.

This submission has been compiled jointly by the City of Edinburgh Council and the Edinburgh Chamber of Commerce. It is intended to demonstrate the economic importance of good and improving international connectivity to Edinburgh and the rest of Scotland. The submission does not consider the implications of the various potential ownership scenarios and does not adopt a formal position as to the organisations preferred outcome for BAA. Rather, it aims only to encourage the House of Commons Transport Committee to:

- (i) Recognise the critical role that Edinburgh Airport plays as Scotland's main business airport and international gateway.
- (ii) Be mindful of the negative economic impact on Edinburgh and Scotland of any new constraints on air connectivity or future investment in the facilities at Edinburgh Airport.
- (iii) Ensure that the need to minimise the risk of any future service rationalisation of services to and from Edinburgh Airport is central to any recommendations made by the Committee.
- (iv) Recognise that the current level of uncertainty surrounding the future of Edinburgh Airport may jeopardise future investment programmes intended to improve facilities for passengers and freight.

EDINBURGH AIRPORT—A STRATEGIC GATEWAY ASSET

Edinburgh Airport is the eighth largest airport in the UK and contributes £287 million to the Scottish economy every year (£250 million in Edinburgh). In 2006 a total of 8.6 million passengersⁱ passed through the airport and this is forecast to continue to grow by 4–5% per annum until 2030. It is estimated that the airport supports 7,200 jobs across Scotland of which 2,300 are directly employed at the airport. Direct airport employment is forecast to increase to 5,700 by 2013 and to 9,000 by 2030 cementing the airports continued role as an important business and major contributor to Edinburgh's economy.ⁱⁱ

In addition to being an important economic actor in its own right, Edinburgh airport also has a more important strategic role as a key gateway to both the Edinburgh city region and the rest of Scotland. Edinburgh Airport now provides regular direct connections to more than 60 international destinations, connecting Edinburgh based businesses to the global market place and acting as the main entry point for millions of international visitors each year.

In addition to international connections, Edinburgh Airport also provides a vital link between Edinburgh and London, directly linking the nation's capital city to the whole of South East England and, via its network airports, to the wider world. This "London link", particularly to the international hub of Heathrow, is seen as vital to the economy of east central Scotland.

Connectivity and Competitiveness

Connectivity, both internal and external, is widely regarded by policy makers and academics throughout the UK and Europe as one of, if not the most important determinant of city competitiveness. A successful city needs quality internal transport infrastructure to move goods and people quickly and efficiently and frequent, direct external links to connect local businesses to markets around the globe.

- Connectivity was identified by Parkinson as one of the key characteristics of a competitive city in his influential work on Scottish cities.ⁱⁱⁱ
- The number and destination of routes from Edinburgh airport was identified in recent research by Experian as having a key role in increasing the region's competitiveness and future economic success.^{iv}
- Improved connectivity has also been repeatedly identified by businesses in Edinburgh as the city's number one economic priority.^v (Key Sectors 2002 and 2006).

As a city Edinburgh recognises the importance of good connectivity to the economy is currently investing heavily in new transport projects. Perhaps the most high profile of these projects is the new tram system which represents an investment of £500 million and will directly connect the city centre to the airport. Work on the system began in June 2007 with trams due to be running by 2011.

West Edinburgh

The proximity of Edinburgh airport and the existence of good links to the rest of the country have helped to make West Edinburgh one of the most important economic development zones in the country. Excellent connectivity has helped to make the area particularly attractive to international businesses—42% of the airports passengers are business travellers—and is considered instrumental in the decision by the Royal Bank of Scotland to locate its world head quarters at Gogarburn. There are currently around 20,000 jobs in the area and further planned development is estimated to have the capacity to provide a further 20,000–30,000 jobs.

Importance to key sectors

Any successful city needs a quality internal transport infrastructure to move goods and people quickly and efficiently. Successful cities also need frequent, direct external links to connect local businesses to markets around the globe. International connections are of particular importance to sectors such as tourism, financial services, life sciences and education—all of which have a significant presence in Edinburgh.

Financial Services

Home to major companies such as the Royal Bank of Scotland, HBOS, Standard Life and Scottish Widows and employing approximately 49,700 people—nearly 17% of the city's workforce—financial services is now the largest single sector in Edinburgh's economy. As the UK's second and Europe's sixth largest financial centre Edinburgh also helps to generate the lion's share of the £5 billion^{vi} that the Scottish financial industry contributes to the Scottish economy on an annual basis.

As a sector with genuinely global reach, efficient transport links to other parts of the UK, and direct air links to the rest of Europe and beyond, are regarded as essential to the future growth of the financial services sector. While recent growth in Edinburgh's international route network has been welcomed by business leaders, the introduction of more routes—particularly to key destinations such as Frankfurt, Madrid, Zurich and Geneva—is seen as an important priority.

The continued expansion of Edinburgh's route network is also seen as key to overcoming negative perceptions about Edinburgh's location on Europe's periphery. Unfortunately, in some quarters, Edinburgh is still considered a remote location that is cut off from real decision making. Challenging this perception and demonstrating to potential investors and recruits that genuine opportunities for business growth and career advancement do exist in Edinburgh is therefore seen as extremely important.

Tourism

Employing around 31,000 people and generating around £1.7 billion per year for the city's economy, tourism is central to Edinburgh's economy. Edinburgh is the UK's second city for tourism, welcoming more tourists each year than anywhere else except London. Edinburgh is also regarded as one of the world's top international conference destinations with an estimated annual market value of £170 million.^{vii}

During 2005 approximately 3.6 million tourism trips were made to Edinburgh, 1.1 million of which were by visitors from overseas.^{viii} In the same year Edinburgh attracted nearly 50% of all overseas visitors to Scotland, confirming the city's role as the key international gateway for Scotland. By 2006 the number of international visitors arriving in Edinburgh had increased to 1.3 million. This growth has been directly attributed to the increase in the number of direct international air services from Edinburgh Airport which has grown from 10 in 1996 to 64 today. The continued expansion of Edinburgh's international air route network is therefore considered vital to the future growth of international tourism in both Edinburgh and Scotland.

The existence of frequent connections to many other UK cities means that the airport has also become a key success factor for domestic tourism in the city. In 2005 2.5 million people visited Edinburgh from the rest of the UK, an estimated 27% of whom arrived by air. This is particularly significant in the context of the growing short-stay and city break market.

Life Sciences

Scotland is now recognised as one of the UK's key life science locations and with 54%^{ix} of total Scottish research activity being undertaken in Edinburgh and the Lothian's, the city region is the focus of much of this activity. The global life sciences market is valued at around \$600 billion^x so this sector is likely to be an important source of high value employment and investment for Edinburgh in the medium to long term.

However, the life science sector in Scotland is still a relatively young industry, accounting for only around 5% of the global market, much of which is concentrated in the USA and Asia. For this reason good long-haul connections are considered “a make-or-break”^{xi} factor in the sector's continued growth and development.

Education

Edinburgh has a historic reputation in the field of education. The city is home to four universities, four colleges of further education and a student population of more than 90,000. The city's universities have an impressive record for research exploitation and the reputation and success of Edinburgh's education sector has been a crucial factor in enabling the city to play a full role in the growing international knowledge economy.

Foreign students are an important component of this student population, adding to the academic knowledge base, increasing diversity within educational institutions and of course providing much needed income. At present there are around 8,110 students from outside Europe studying in Edinburgh, with many more from within the European Union. The airport and international connectivity it provides is a key factor in attracting these students and helps to ensure that Edinburgh's colleges and universities are able to attract students of the very highest calibre from all over the world.

Conclusions and recommendations

Edinburgh Airport is the pre-eminent business airport in Scotland. In recent years its growth has outperformed the other Scottish Airports, attracting more carriers flying to more destinations and consequently becoming the busiest airport in Scotland.

BAA Scotland deserves recognition for its management of the airport and the growth it has generated in the city region economy. BAA has invested more than £220 million in upgrading terminal and airfield facilities at Edinburgh Airport over the past 10 years resulting in a smoother and altogether more agreeable experience for the business and leisure traveller. This includes the £1 million Air Traffic Control Tower which opened in 2005.

In considering the future of the airport and its ownership, Edinburgh Chamber of Commerce and the City of Edinburgh Council would wish any regulatory and ownership framework to acknowledge:

- The strategic importance of the West of Edinburgh corridor as a development opportunity for national and international headquarters and high value added jobs.
- The attractiveness of Edinburgh to carriers as the airport of choice in Scotland for the business travellers and, therefore, the importance of maintaining a management ethic focussed upon efficiency, courtesy, quality and service.
- The need for Edinburgh to grow its airport and therefore its economy in a sustainable way, by encouraging its owners to invest in facilities and services for carriers and passengers as good or better than any found elsewhere in the world.
- The absolute correlation between the growth and prosperity of the airport and the parallel growth and prosperity of the Scottish economy.
- The requirement for strategic agreements with airport owners and operators to encourage and reward investment in facilities, infrastructure and services.

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- ^{xi} Experian Economic Audit, 2006.

November 2007

Memorandum from American Airlines Inc (BAA 22)

On behalf of American Airlines, Inc, thank you for the opportunity to provide comments to the Transport Committee regarding the future of BAA.

1. American is proud to serve three London airports from seven US gateways. We currently fly to Heathrow from Boston, Chicago, Los Angeles, Miami and New York, Gatwick from Dallas/Fort Worth and Raleigh-Durham and Stansted from New York. In 2008, we will be shifting our Raleigh-Durham service along with one of our Dallas/Fort Worth flights to Heathrow. In short, Heathrow is the primary connecting hub for the oneworld Alliance, as it is served by seven of American's nine oneworld partners. Simply stated, both London generally and Heathrow specifically are vital and important gateways for American's European service.

2. Unfortunately, BAA's mismanagement of its London airports has cost American millions of dollars in higher landing fees, reduced operational performance and lost revenue as passengers choose to connect through other European hubs. We believe that these problems stem in large part from the conclusion reached by the OFT in its study of UK airports—lack of competition has led to lower quality services and higher prices. Any frequent traveller comparing Heathrow and Gatwick to other major European hub airports would likely echo the sentiment that the BAA owned London airports are poorly maintained, equipment is often inoperable, and the customer experience is simply unacceptable. As such, we strongly supported the OFT's referral of its investigation and report to the Competition Commission.

American Airlines has significant concerns regarding BAA's ownership of London Airports

3. American has three primary concerns with BAA's ownership and management of its London airports. First, BAA's joint ownership of Heathrow, Gatwick and Stansted has created an inefficient and unfair incentive for BAA to subsidize Stansted at the expense of Heathrow and Gatwick. Second, BAA's mismanagement of Heathrow has made it an inferior connecting hub when compared to Frankfurt, Paris or Amsterdam. Third, BAA is so consumed with building new facilities—such as Terminal 5 and Heathrow East Terminal—that it ignores Terminal 3, allowing it to decay to the detriment of BAA's customers—consumers and the airlines they fly. Each of these concerns is discussed in turn.

BAA can use Heathrow and Gatwick to effectively cross-subsidize its development of Stansted

4. BAA's joint ownership of Heathrow, Gatwick and Stansted allows it to effectively cross-subsidize Stansted's growth at the expense of the other two airports. For example, the OFT study cited concerns by certain carriers that "increased airport charges at Stansted to fund development could not simply be passed through to air travellers," and that if "a low cost airline's costs rose to the point at which a particular service no longer achieved the required rate of return, then the service would simply be withdrawn."³⁷ While this may not suggest that BAA should raise landing fees at Stansted, neither does it suggest that other carriers should provide de facto subsidies that development through higher landing fees at Heathrow and Gatwick.

5. For example, if Stansted were owned separate and apart from Heathrow and Gatwick, its owner would develop the airport based on its ability to generate revenue from improving Stansted—whether through higher fees or increased throughput. Stansted would have an incentive to compete with Heathrow and Gatwick, as the "[f]ailure to invest, where a rival airport is expanding, can lead to a loss of business from airlines."³⁸ With common ownership, however, BAA is able effectively cross-subsidize its development with fees paid by airlines at other airports. Since the rival airports are under common ownership, there is no "loss" of business—and thus fewer incentives to investment. As the OFT study notes, BAA has "an incentive to delay Heathrow investment while upgrading Stansted, as this would reduce the investment risk at Stansted."³⁹ Such cross-subsidization is unfair to those airlines paying high airport fees at Heathrow and Gatwick (and to their customers), only to see that money invested elsewhere.⁴⁰

BAA's mismanagement Of Heathrow has made it a high-cost low-quality European hub

BAA's airport fees have skyrocketed while the quality of its service has plummeted

6. The OFT study notes that price increases at BAA's airports are capped—but American questions whether these caps reflect anything more than a government sanctioned extraction of monopoly profits from the airline industry. As the study notes, the CAA limits fee increases at Heathrow to the rate of inflation plus 6.5%, while increases at Gatwick and Stansted are limited to the rate of inflation plus 5.0%.⁴¹ As a result, fees at Heathrow have jumped more than 20% in just the past two years.⁴² Despite BAA's poor management of BAA airports, it has been given the ability to raise fees at an even greater rate during the

³⁷ Office of Fair Trading, *UK airports: Report on the market study and proposed decision to make a market investigation reference*, p 83–84 (December 2006).

³⁸ *Id* at 36.

³⁹ *Id* at 83.

⁴⁰ This subsidy to carriers serving Stansted is particularly unfair given the fact that many of those carriers posted record profits for 2006. See Press Release, *Ryanair Announces Record Q3 Results—Net Profit Rises 30% to €48 million—Full Year Guidance Raised From €350 million to €390 million*, 5 February 2007.

⁴¹ *Id* at pp 24–30.

⁴² *Id* at p 88.

Fifth Quinquennium (Q5). Never-ending fee increases might be more palatable if they led to better service and more efficient operations at BAA airports. Unfortunately, history has shown precisely the opposite to be true.

7. The OFT study notes that “[w]hile airports do not directly charge passengers to enter the airport, the costs borne by airlines in passenger and landing charges are, to some extent, passed on in higher airfares.”⁴³ To the extent that networks based at Heathrow bear costs that are higher than those incurred by networks based in Paris, Amsterdam or Frankfurt, a competitive imbalance results. Airlines at the more expensive hub airport are thus forced to decide between: (a) recovering their costs while being uncompetitive on price; and (b) being competitive on price but not recovering their costs. Since airlines generally cannot switch airports in the short-run, such an imbalance leads to market failure.

8. BAA’s argument that “countervailing buyer power of airlines may reduce the market power of BAA” is simply unsupported by the evidence.⁴⁴ The OFT correctly notes that “the fact that [airlines] are unable to [negotiate discounts off BAA’s charges] at Heathrow and Gatwick demonstrates that competition is restricted.”⁴⁵ If even British Airways is unable to negotiate with BAA, carriers with a far smaller presence at BAA airports (like American) have absolutely no hope of doing so.

Examples Of BAA’s Inadequate Planning For Operational Disruptions

9. No better reflection of BAA’s inadequate planning for operational disruptions at Heathrow and Gatwick can be found than the Airports Council International survey of passenger satisfaction cited in the OFT study—Gatwick ranked 49th and Heathrow 56th out of 58 total airports.⁴⁶ Two specific examples of BAA’s failure to adequately plan or to demonstrate leadership in responding to operational disruptions are the 2005 Buncefield fire and the 2006 security scare—each of which created costly disruptions for airlines and passengers. In both cases BAA’s response to the crisis was inadequate, as capital allocations to airside infrastructure investment was not made a high enough priority.

Buncefield

10. A prime example of BAA’s failure to adequately plan and provide leadership at Heathrow (despite hiking fees more than 20% over the past two years) is its response to the fire at the Buncefield fuel depot on 11 December 2005. Buncefield supplied 30% of the jet fuel used by airlines at Heathrow, and the fire severely disrupted the already delicate balance between supply and demand. The disruption persists to this day, and had an extremely disruptive impact on the Summer 2006 scheduling season. Non-UK carriers (including American) were discriminated against in fuel allocations, forcing them to incur the cost of ferrying fuel into Heathrow while their UK rivals were favored by preferential allocations.⁴⁷ While fuel supplies were later distributed in a more equitable fashion, BAA failed to exercise any leadership on this issue. The solution in place today exists in spite of—not because of—BAA’s efforts.

11. Nor has BAA provided any leadership by creating a plan to avoid or minimize anticipated fuel shortages in the future, particularly during the heavy summer season. Nearly two years have passed since the Buncefield fire, and BAA has still done little to create an adequate long-term solution to address the current demand for fuel at Heathrow. While BAA saw fit to tender 750 million to shareholders in an attempt to stave off the Ferrovial takeover,⁴⁸ that money would have been better invested in improving fuel facilities at Heathrow. Long after the fire, BAA is still rationing fuel at Heathrow during peak periods.

August 2006 Terrorism Alert

12. While the security threat of 10 August 2006 was significant and unprecedented, it highlighted the fact that BAA has for years failed to adequately invest in security infrastructure at Heathrow and Gatwick. For example, rather than utilizing existing terminal space to create additional checkpoints and other security measures, BAA instead invested in retail outlets. The same is true for the security control posts used by airport personnel and vendors on airport property—BAA has failed to provide adequate investment to ensure a smooth yet secure flow of people and goods on and off airport property.

13. As a result, the two airports were completely unable to handle a shock to the system. By comparison, other international airports in Europe saw far fewer disruptions and returned to normal far more quickly than those operated by BAA. As the OFT study notes, “other airports in the UK suffered less disruption due to a more cooperative and efficient handling of the situation as it arose.”⁴⁹ American estimates that it lost millions of dollars as a result of BAA’s having inadequate contingency planning or infrastructure to respond to the threat. Even today—over a year after the security scare—the security screening process at

⁴³ *Id* at p 35.

⁴⁴ *Id* at p 79.

⁴⁵ *Id* at pp 79–80.

⁴⁶ *Id* at p 93.

⁴⁷ For American alone, this added over \$4 million in costs to its Heathrow operations.

⁴⁸ *Id* at p 74.

⁴⁹ *Id* at p 94.

Heathrow and Gatwick is simply unacceptable. Yet this result is not inevitable. In fact, despite being forced to handle the same threats, American's other gateway airports in Europe (including privately-owned Manchester Airport in the UK) have provided far better customer service.

BAA's development Of Terminal 5 And Heathrow East Terminal have left Terminal 3 as an inferior facility

14. BAA has been so distracted by the construction of Terminal 5 that those airlines consigned to Terminals 1, 2 and 3 have suffered from the neglect of their facilities for years. For those currently located in Terminals 1 and 2, the situation will get better as they migrate into Terminal 4 and the planned Heathrow East Terminal. However, significant pressure from **oneworld** and Terminal 3's other tenants was required to get a commitment from BAA to improve this aging facility. For example, it took months of prodding for BAA to form a working group to design an upgrade of Terminal 3's baggage systems (the poor performance of which leads to consumer frustration over baggage delivery performance), and to agree to upgrade Terminal 3's customer facing areas (which have led to consumer frustration over the facility's appearance and even operability).

15. In response to concerns that Terminal 3 is being ignored, BAA committed to members of **oneworld** that it planned to invest in Terminal 3 infrastructure, including customer-facing and baggage facilities. However, BAA's timeline is still unacceptable to **oneworld** as it does not commit to completion of these projects until 2012.

16. At Heathrow, the lack of competitive equivalence would operate to the detriment of both American and interalliance competition, because BAA has planned to organize terminals by alliance affiliation.⁵⁰ As a result, BAA's mismanagement of Terminal 3 will mean that American is relegated to Heathrow's worst terminal, while its competitors enjoy the fruits of BAA's inflated airport charges at their new facilities. While BAA recognizes the concept of competitive equivalency,⁵¹ there is a long way to go before Terminal 3 meets that standard.

17. Because this restructuring of Heathrow's terminals around alliances would place **oneworld** at a significant competitive disadvantage given the neglect of Terminal 3, the alliance informed BAA in December 2005 that:

Our support for closing Terminal 2 assumes that the current Terminal 3 facility and baggage system refurbishment proceed as planned. Additionally, we do not want a situation where funds and BAA focus shifts to the expected new Heathrow East Terminal, thereby resulting in a diminished attention on Terminal 3. Completion of an upgraded Terminal 3 is essential to the competitive equivalency principle on which we have all agreed. A refurbished Terminal 3 is essential to the **oneworld** alliance—and to BAA as well.

Unfortunately, BAA continues to appear less interested in maintaining its current facilities than it is in its more high profile construction projects. Such a situation is unfair to those airlines relegated to Terminal 3, as we have little competitive recourse against BAA that would force them to provide substantially equivalent services to all carriers serving Heathrow.

BAA should be given incentives to improve Heathrow as a connecting hub on par with other major European airports and ensure competitive equivalency across Terminals

18. American supports the following remedies to improve BAA's management of London airports:

- Bringing BAA airport charges more in line with those of comparable European airports, and obtaining assurances that increases in those charges will be efficiently invested in airport improvements;
- Separating—whether by divestiture or some other remedy—the economic interests controlling Heathrow, Gatwick and Stansted in order to ensure that airlines serving one airport are not forced to cross-subsidize the development of another;
- Imposing higher service standards on a broader range of metrics at BAA airports so that airlines and consumers do not have to needlessly suffer due to poorly maintained infrastructure and a lack of leadership; and
- Demanding competitive equivalence at BAA airports for all users, so that airlines can compete for customers on a level playing field, rather than handing modern new facilities to members of the Star and SkyTeam alliances, British Airways and other airlines.

⁵⁰ Once construction of Heathrow East Terminal is complete, the competitive landscape at Heathrow will be as follows:

- Heathrow East Terminal: Star Alliance carriers;
- Terminal 5: British Airways;
- Terminal 4: SkyTeam carriers;
- Terminal 3: **oneworld** carriers and Virgin Atlantic.

⁵¹ The principle of competitive equivalency aims to allow consumers to choose between airlines based on their product offerings as opposed to the disparate quality of facilities provided by airport authorities.

Again, American appreciates the Transport Committee's invitation to comment on its inquiry into the future of BAA. We would be interested in participating in the Committee's hearing on 28 November 2007, and welcome the opportunity to provide any further information, to answer questions, or to meet with your staff on this very important issue.

November 2007

Memorandum from the Glasgow Prestwick Airport Consultative Committee (GPACC) (BAA 23)

I write in my capacity as Chairman of the Glasgow Prestwick Airport Consultative Committee (GPACC). The Committee has a broad representation drawn from the local community and other stakeholders of Glasgow Prestwick Airport (GPA).

GPACC are aware that to a large extent the air passenger market in the Central Belt of Scotland operates as a single market. The spatial extent of market areas for air passengers for Glasgow, Edinburgh and Glasgow Prestwick airports have a considerable degree of overlap. The Committee are also aware that currently BAA as operators of Glasgow and Edinburgh airports have a significant share of this Central Scotland air passenger market (ie 88% in 2006) and that if passenger growth is in line with the forecasts in the Air Transport White Paper 2003 this share will be maintained to 2030.

The degree of market power that operating both Glasgow and Edinburgh Airports gives BAA in the Central Scotland air passenger market is of concern to the Consultative Committee. In particular, the potential for this market power to be used to the detriment of not only airport users in Central Scotland but also the wider public interest and specifically the interests of Glasgow Prestwick, its stakeholders, customers and passengers. In our view this matter merits further investigation.

GPACC are of the firm view that as there is significant spare capacity in the infrastructure legacy at GPA it is in the interests of not only airport users at GPA and throughout Central Scotland but also society generally that the use of that capacity is maximised before additional transport infrastructure investment is promoted at either Edinburgh or Glasgow airports—in terms of both airport capacity itself or in terms of relative improvements in the surface accessibility of those two airports *vis à vis* Prestwick.

As your consultation has fallen between meetings of the GPACC I must point out that while I write on their behalf this matter will not have been openly debated by the Committee before the close of your consultation period. However a draft of this letter has been circulated to all GPACC members for comment which where appropriate has been incorporated into this final version.

October 2007

Memorandum from Plymouth City Council (BAA 24)

1. EXECUTIVE SUMMARY

1.1 London major network airports of Heathrow and Gatwick are, and have been severely congested for a number of years. Services to many UK peripheral regions have been lost or are under serious threat due to the increasing value of slots at Heathrow and Gatwick and the value of deploying slots from regional services to more lucrative alternative use. And yet in over 40 years of control, BAA have not delivered a single extra runway. In 2006, BAA handled 91% of air passenger traffic in the South East. As long as BAA maintains this monopoly grip over this key market, there is little incentive to improve service quality or to grow crucial runway capacity.

1.2 Regional air links to London network airports are critical to the sustained economic development and social cohesion of cities such as Plymouth.

1.3 Given the ever increasing pressures on capacity at Heathrow and Gatwick, Plymouth City Council are increasingly concerned that Plymouth City Airport will be unable to maintain its vital regional air service to London. We have already lost our link to London Heathrow and have no guarantee of continuity of our vital link to London Gatwick.

1.4 Plymouth City Council does not believe that the regulatory regime has been effective in incentivising BAA to deliver additional core runway infrastructure. It believes a more fundamental restructuring of BAA is required to address its monopoly on the air passenger market in London and the South East.

1.5 The UK's gateway hub airports are too important to the nation for them to be vested in a company whose sole duty is to its shareholders rather than the broader economic and social needs of the country and cities such as Plymouth which rely on the vital air service links and connections that they afford.

2. SUBMITTER

2.1 This evidence has been prepared by Plymouth City Council. Plymouth City Council owns the freehold to Plymouth City Airport and amongst other roles is responsible for the economic development of the City. The airport is operated by Sutton Harbour Holdings plc under lease.

3. FACTUAL INFORMATION

3.1 *BAA structure*

3.1.1 BAA was established under the Airports Authority Bill of 1965 as the monopoly provider at the three key London airports of Heathrow, Gatwick and Stansted. BAA became a privatised company in 1987. In 2003, EC rules forced the UK government to abandon its golden share in BAA and this paved the way for BAA's takeover by Ferrovial in 2006.

3.1.2 London major network airports of Heathrow and Gatwick are, and have been severely congested for a number of years. Services to many UK peripheral regions have been lost or are under serious threat due to the increasing value of slots at Heathrow and Gatwick and the value of deploying slots from regional services to more lucrative alternative use. And yet in over 40 years of control, BAA have not delivered a single extra runway. In 2006, BAA handled 91% of air passenger traffic in the South East. As long as BAA maintains this monopoly grip over this key market, there is little incentive to improve service quality or to grow crucial runway capacity.

3.1.3 As a monopoly provider at the London airports, BAA are subject to price control regulation by the CAA through the Competition Commission. However after five quinquennial reviews, it is clear that the regulatory regime has been ineffective in incentivising BAA sufficiently to deliver capital investment in line with demand. This has led to congested terminals; overcrowded skies through the increased use of stacking; schedule inflation (ie lengthening of published airline journey times); the reduction in the network and frequency of services as compared with competing European hubs and the loss of regional services.

3.1.4 For BAA, developing additional revenues through retail growth on the existing passenger base is more attractive than increasing revenues through growing capacity and therefore passenger growth for a number of reasons:

- BAA are not incentivised sufficiently to deliver additional growth through capital investment. In addition the regulatory penalties are not sufficient to incentivise BAA to maintain and improve service quality.
- Because of the single till regulation, developing retail services offers a quicker return on a smaller investment than developing long-term capacity improvements.
- BAA have been recently taken over by Ferrovial. This has resulted in a more highly geared debt structure that further favours short-term gain over long-term investment.
- There are significant planning constraints and environmental barriers to developing additional capacity that further exacerbate the situation and make long-term investment unattractive. In this respect, the Government's priorities, as set out in the Future of Air Transport—White Paper, versus its commitment to meet local air quality and globally agreed emission targets are far from clear.
- Despite the production of a clear statement of Aviation Policy, some three years later the UK remains further away from provision of new runway capacity for London than when the paper was published. The White Paper had envisaged the first new runway being available at Stansted by 2011–12. Subsequent developments have shown that the earliest that this is likely to happen will be at least 2015, possibly 2020, and then at Stansted not Heathrow or Gatwick which are the key locations for services to or from Plymouth.

3.2 *Impact on Regional Services*

3.2.1 The problems of constrained capacity at Heathrow and Gatwick and their impact on regional air services have been with us for many years. In the eighth report on Regional Air Services, the Environment, Transport and Regional Affairs Committee concluded in 1998 that:

“Runway capacity in the South East of England is in short supply. This shortage puts pressure on regional air services. The Government must address the question of capacity in the South East as a matter of urgency.”

“Regional links to London airports are economically important. The economic value of air links from the regions to Heathrow is greater than that of access to any other airport in the South East owing to the high frequencies and vast choice of worldwide connections it offers from its two runways, which

results in four times as many scheduled passengers travelling from Heathrow as from Gatwick. The higher frequencies offered by airlines from Heathrow on the trunk domestic routes means that even for passengers flying to or from London, Heathrow is generally more convenient.”

“Services to continental hubs are an inadequate substitute to Heathrow since neither Amsterdam Schiphol nor Paris Charles de Gaulle offer the choice of flights or the high frequency that are available at Heathrow. It is not in the economic interests of the UK for passengers to use foreign hub airports, since they are extremely likely to travel on foreign carriers.”

3.2.2 The economic interest of airlines lies in maximising the proceeds from the use of the limited number of existing slots at Heathrow and Gatwick. Domestic services are less profitable than long-haul ones. Shortage of runway capacity at Heathrow and Gatwick has meant that Heathrow has concentrated on becoming an international hub airport with many regional services transferred to Gatwick or lost altogether. Gatwick has concentrated on international point to point and the charter market although some of this has been displaced by the low cost carriers. The recent acquisition of GB airways by easyJet has been most likely motivated by the opportunity to acquire additional slots at Gatwick, its most profitable base. GB airways have kept its five pairs of slots at Heathrow presumably to sell them to the highest bidder.

3.2.3 These substitution trends are set to accelerate now that an Open Skies deal has been agreed with the United States. With scheduled slots at Heathrow worth up to £15 million a pair on the “grey market”, there is every incentive for airlines to sell to the highest bidder. In addition, as the airports become more and more constrained, so there is a general drive to increase aircraft size and to move from short/medium haul operations to medium/long haul, again driving out regional air services.

3.2.4 Many regional airports have grown significantly since 1998 with the advent of the growth of the low cost carriers. However, this capacity growth has only satisfied one aspect of the needs of the local populations since, without vital regional air links to network hub airports, passengers are unable to access the long haul international market.

3.2.5 The slide below highlights the extent to which regional air services have been lost or remain under threat because of the lack of capacity at Heathrow and Gatwick.

3.2.6 The slide shows that many of the regional air services that have been lost altogether are the shorter routes from London which are generally under three hours away by train.

3.2.7 Whilst it might be seen by some as a positive step to displace passengers from air to rail this has not been through passenger choice. Rather it is the airlines that have withdrawn these services because of the lack of capacity at Heathrow and Gatwick, forcing passengers to use often just as costly and more inconvenient rail links. As regional air services at the London airports become ever more constrained, passengers are being faced with fewer and fewer options. The well publicised deterioration in service at the congested London airports versus the expense and inconvenience of the rail alternative is making the travelling experience an ever more unpleasant one.

3.3 Impact on Plymouth City Airport

3.3.1 Plymouth is five hours away from London by car, and some 3.5 to four hours by rail, making day return trips by surface means untenable, and leaving air services vital for such trips. It falls in the band of regional airports (see graph) that are now most at risk from the continuing lack of additional capacity at Heathrow and Gatwick. Plymouth has a population of 241,000 people but the airport has a catchment area of about 1.2 million. Plymouth has attracted overseas investment in the service industry, light manufacturing and pharmaceuticals as it transitions from its traditional naval heritage.

3.3.2 There are no major international air services out of Plymouth and its population relies on the four times daily service to Gatwick provided by Air Southwest. The regional air service from Plymouth to London was first introduced in 1981 by Brymon Airways and was initially to Heathrow. When BA took over Brymon, the service was switched to Gatwick under BA Connect. These routes were later transferred to Air Southwest.

3.3.3 The regional air service is the only way of accessing the international network. In addition, the regional air service provides the only workable means for business travel to/from London. Four hours by train or five hours by car are not feasible alternatives for the business traveller for a daily round trip.

3.3.4 In 2002, Sutton Harbour Holdings carried out a survey of businesses that use the local airport. Some of the comments received include:

“economic progress for the city of Plymouth will be severely hampered without access to a city rated airport”;

“difficult connections cause great problems with trying to be taken seriously as a major player within our organisation”;

“re-instating the Plymouth-Heathrow route would help our business enormously.”

These comments support the view that local businesses need access to international destinations.

3.3.5 These comments are further backed up by CAA survey data from 2000 which showed that a significant number of passengers were using the regional air service from Plymouth to Gatwick for onward travel to Brussels, Frankfurt, Dubai, Bahrain and New York. The same survey data also showed that other destinations, available from Heathrow but not from Gatwick, that were important to the local business community in Plymouth, included Boston, and Tokyo.

3.3.6 This reliance by Plymouth on its regional air service to London has been recognised by the Government. In the 2003 White Paper on the Future of Air Transport it was concluded that developments at Plymouth City Airport “were essential to facilitate continued operation of the existing Plymouth/Newquay—London Gatwick Service, and to enable other routes to be established.”

4. RECOMMENDATIONS FOR ACTION

4.1 Given the ever increasing pressures on capacity at Heathrow and Gatwick, Plymouth City Council are increasingly concerned that Plymouth City Airport may be unable to maintain its regional air service to London.

4.2 As evidenced by the lack of new runways to date, Plymouth City Council does not believe that the regulatory regime has been effective in incentivising BAA to deliver additional capacity growth at its London airports through capital investment. Plymouth City Council further believes that the current well publicised deterioration of service at the London airports is also a symptom of failed regulatory incentives.

4.3 Plymouth City Council therefore believes that a more fundamental restructuring of BAA is required and asks the Transport Select Committee to make recommendations for a change in BAA’s monopoly hold on the air passenger market in the South East.

4.4 Plymouth City Council also asks that a restructured BAA be given much clearer guidance from the Government regarding its priorities for runway development, as set out in the Transport White Paper, versus its commitment to meet local air quality and globally agreed emission targets.

November 2007

Memorandum from NATS (BAA 25)

1. INTRODUCTION

1.1 NATS is the UK’s leading provider of air traffic management services. We are regarded as a world leader in our industry and have recently been voted the best Air Navigation Services Provider (ANSP) in the world in an independent survey of the industry including other ANSPs, systems manufacturers and airlines.

1.2 NATS was established as a PPP in 2001 and is now owned 49% by the UK Government, which also maintains a special share; 42% by The Airline Group, a consortium of UK airlines; 5% by its employees, and 4% by BAA.

1.3 BAA acquired its shareholding in NATS in 2003 as part of the company’s regulatory and financial restructuring following the adverse economic impact of 9/11; this included an investment of £65 million by BAA. BAA holds one seat on the NATS Board.

1.4 NATS comprises two businesses. NATS En Route Ltd (NERL) is the monopoly provider of en-route air traffic services in the UK and the north east quadrant of the North Atlantic, provided under licence from, and regulated by, the Civil Aviation Authority; NATS Services Ltd (NSL) is NATS’ non-regulated business providing air traffic services at many UK airports and is NATS’ interface with the wider UK and global ATM markets.

2. BAA AS A CUSTOMER

2.1 NSL currently holds the contract for provision of air traffic services at 15 of the UK’s major airports, including BAA’s seven UK airports.

2.1.1 NSL provides BAA, one of its largest customers, both with airport Air Traffic Services and other support services based on NATS’ expertise including the design and fit-out of control towers, airspace design, navigation and surveillance aids.

2.1.2 Provision of safe and efficient airport air traffic services, which includes Approach & Departure Control and Ground Movement Control, requires significant, ongoing investment by both the airport customer (infrastructure such as control towers and systems) and by the ATS supplier (procedures, training and engineering installation and support).

2.1.3 Stability is vital in encouraging the right environment to invest and innovate, enabling safe, efficient and value for money services to be delivered whilst allowing an appropriate return on investment.

3. UK PLC

3.1 The UK airport Air Traffic Control market is the most contestable ATC market in Europe, providing others with opportunities to compete in the UK market, but without the opportunity for NATS to compete in other European markets.

3.2 Whilst this environment fosters better performance in terms of service and value for money, it can also lead to uncertainty over the long-term stability of contracts and therefore long-term investment.

4. AIRSPACE DEVELOPMENT

4.4 Airspace infrastructure is as critical as ground infrastructure in growing airport capacity in line with the Government's aviation policy; it requires long term planning and development. This is especially complicated in south-east England where the competing demands of almost 40 airfields contribute to the busiest, most complex airspace in the world.

4.4.1 NATS relies on strong cooperation from the airports in designing airspace to accommodate overall growth in demand and it would be unhelpful to complicate this process further, particularly in respect of the major airports in the region.

4. PLANNING APPLICATIONS

4.1 NATS is aware of the Government's pending consultation into future expansion of Heathrow; the outcome expected in the New Year of the public inquiry into Stansted's application to maximise use of its current runway; and Stansted's application, also expected next year, to build a second runway.

4.2 NATS observes that the UK planning process is too slow; this complicates long-term developments which require both vision and commitment; it also underlines the importance of long term commitment by airport operators in order to secure stability.

4.3 BAA has invested heavily in state of the art control towers at its airports and NATS has responded by investing in similarly innovative systems technology which has enabled us to reach a point where Gatwick is the most intensively used single runway airport in the world and Heathrow is the most intensively used dual runway airport.

4.4 In our response to the Government's consultation on the future of aviation (leading to the 2003 White Paper) NATS said it is more efficient in airspace terms to maximise use of existing airports than to build new ones.

5. CONCLUSION

5.1 NATS believes the future needs of the UK economy are best served by a strong and stable aviation sector, which includes a strong network of gateway airports able to provide the investment necessary to maintain the UK's competitiveness.

5.2 This has been made possible by long experience enabled by strong long term contractual relationships. We believe BAA should be encouraged to operate in a way in which such long term commitments can flourish.

5.3 NATS supports the competitive contestable principle long-term but believes immediate policy priority should be to create stability for long term investment decisions compatible with the industry's safety, service and environmental priorities.

November 2007

Memorandum from the Civil Aviation Authority (BAA 26)

SUMMARY

1. The CAA welcomes the opportunity to submit written evidence to the Transport Committee's inquiry into the future of BAA. The CAA agrees that BAA's airports are a vital part of the country's infrastructure, and that BAA faces a number of significant challenges, especially at Heathrow. It therefore agrees that it is timely to consider how the company, the Government and other stakeholders (including the CAA) are responding to the current situation, and how they will respond in future. This submission focuses on the CAA's role as the economic regulator of BAA's airports, and in particular the London airports, although the Committee will be aware that the CAA also regulates other aspects of BAA, in particular safety at its airports, and is responsible for airspace planning.

2. In summary, this submission sets out:

- a brief overview of the current situation, highlighting the fact that the overall performance of these airports, in particular those in the London area, is dependent on a wide range of institutions including BAA, but also including the DfT's Transport Security Directorate (TRANSEC), the Border and Immigration Agency, and the airlines using these airports;
- a description of the CAA's role under the current economic regulatory framework, and how it is discharging key elements of that role including setting limits on airport charges at Heathrow and Gatwick airports from 1 April 2008 (including applying strengthened incentives on service quality at Heathrow and Gatwick) and advising the Government on the case for ending economic regulation of Stansted airport; and
- the CAA's current views of the potential for future changes to the economic regulatory framework (either through the Competition Commission's market inquiry into BAA or through the Government's recently announced strategic review of the CAA), and some considerations that the CAA believes should be fed into any reform or re-design of the current framework.

THE CURRENT SITUATION

3. BAA's London airports are each in their own right major nodes in the UK's international transport network, performing towards the limits of their current physical capacities. Heathrow remains the world's busiest international airport, with utilisation of its two runways approaching 100%; Gatwick is the world's busiest single runway airport; and Stansted has delivered the fastest growth of any major UK airport in the past decade.⁵²

4. There has recently been a great deal of focus on the performance of Heathrow particularly. There have undoubtedly been problems for passengers and airlines, exacerbated by changes to security requirements following August 2006. As recent improvements have shown there is a good deal that BAA management can do to improve the Heathrow experience. However, the context within which BAA operates is of an airport which for many years—and to an increasing extent—has been operating well beyond its designed terminal capacity, in buildings designed for a different era with the operational constraints this implies. The opening of Terminal 5 (T5) should afford significant relief both through providing a new, purpose built terminal for some 35 million passengers and relieving overcrowding elsewhere. However, it will also enable the modernisation of the east end of the airport and that, along with the airline moves between terminals it entails, will create its own pressures. BAA will have a significant challenge in managing these and the large construction programme designed to deliver the next stage of modernisation.

5. Terminal and other developments will not, of course, relieve the operational constraints implied from virtually 100% utilisation of two runways. The Government's consultation on a third runway and mixed mode will be relevant to this.

6. Each of BAA's London airports is a substantial and complex business in its own right, the ongoing success of which (in terms of safety, passenger experience, operational efficiency, and financial performance) depends on complex inter-actions between the airport operator, airlines, air traffic control, border and security authorities, and surface transport agencies. The particular capacity constraints at both Heathrow and Gatwick put a premium on the different parties working together to deliver a proper service to passengers. Many of the aspects of service experienced by the passenger—check-in, baggage reclaim and border checks—are outside BAA's control and a particular challenge for BAA is to seek to coordinate them to the overall benefit of the airport. Looking to the future, the prospects for expansion at any of these airports is necessarily bound up in a wider political process involving local, regional and national Government, and those affected by the airports' activities and their flight paths.

⁵² Annual passenger growth in the 10 years from 1996 to 2006 averaged 17%, higher than all UK airports with 2006 passenger traffic above five million.

 ROLE OF THE CAA'S ECONOMIC REGULATION GROUP

7. Within this nexus of commercial and regulatory relationships, the CAA's economic regulation is designed to protect airport users (passengers, freight shippers, and airlines) from the unreasonable exploitation of monopoly power by each airport. In doing so, the CAA must also promote the efficient, effective and profitable operation of UK airports, and encourage investment in time to meet demand. The CAA has limited tools with which to fulfil its statutory duties, essentially price caps which are required to be set every five years, conditions which may be attached to such price caps, and specific conditions designed to remedy any actions by the airport against the public interest.⁵³ So the CAA's economic locus and vires are tautly specified in statute. While the CAA endeavours to make the most effective use of its regulatory powers to achieve the goals set for it by Parliament, it should be recognised that the broader performance of each airport over time is primarily the responsibility of the airport operator and is dependent upon its management of a wide range of commercial and stakeholder relationships.

Price control regulation of Heathrow and Gatwick airports

8. The CAA is nearing the end of its latest quinquennial review of Heathrow and Gatwick airports, which will culminate in the application of new maximum limits on airport charges at these airports from 1 April 2008 for a five year period. (The CAA's comments in this note are based on its previous regulatory policy statements, its evidence to the Competition Commission (CC) and the CC's own recent report. This note does not prejudge the CAA's substantive regulatory proposals document for Heathrow and Gatwick airports, which it plans to publish on 20 November 2007.)

9. During the current price control review, the CAA has sought to develop its regulatory approach to tackle some of the challenges facing BAA's London airports. At Heathrow and Gatwick, this has been through more constructive engagement between BAA and its main airline partners on the current operation and future development of each airport, and greater regulatory incentives towards better service delivery and capital investment.

10. The CAA's view is that the primary challenge facing BAA is to deliver a better service to passengers and airlines, based on refreshed and expanded infrastructure. The challenge for the CAA in its economic regulation of the airports is to send sufficiently strong and credible incentives to BAA that it recognises that it is in its own commercial interests to move in this direction. The current price control review comes shortly after the acquisition of BAA plc by the financial consortium ADI⁵⁴ led by Grupo Ferrovial SA in early summer 2006, the service disruptions following heightened security requirements from August 2006, and with rising demand at each airport placing increasing pressure on stretched facilities and service performance. It thus provides a timely opportunity for the CAA, taking due account of advice from the Competition Commission,⁵⁵ to take stock of the effectiveness of its price control regulation to date and to refine and recalibrate it for the challenges of the coming five-year regulatory period.

11. The foundations of a better airport experience for BAA's passengers, and a more efficient environment for airlines, and a safe airport for all users, are BAA's current assets and future investment plans. Economic regulation has provided sufficient incentives to date for BAA to progress T5 at Heathrow on time and budget, with some facilities accelerated to allow BA to collocate the bulk of its operations from spring 2008. Smaller, but nevertheless important, projects have also been delivered at Gatwick in recent years. The principal brake on Heathrow investment to date has been delay arising from the UK planning system, while at Gatwick the pace of investment has had to be reshaped at various stages to reflect the changing plans of airlines there, most notably after the events of September 11 2001 which reduced passenger growth substantially.

12. Looking forward, BAA has proposed to the CAA and its airline users ambitious investment plans for both airports for the coming five-year regulatory period, some £3.5 billion at Heathrow and some £0.8 billion at Gatwick.⁵⁶ These plans have benefited from extensive consultation between BAA and airline users, which has been encouraged by the CAA as part of a programme of constructive engagement, designed to ensure that the CAA's regulatory decisions are fully reflective of the particular requirements of airlines and passengers. At Heathrow, BAA is planning to complete the Terminal 5 satellite C, to refurbish Terminals 3 and 4, to build a new Heathrow East Terminal, and to improve the capacity and efficiency of airfield facilities such as aircraft stands and piers. At Gatwick, BAA is planning to improve the capacity and service performance of its existing North and South Terminals, and to enhance the level of pier service.⁵⁷

⁵³ Public interest conditions can only be imposed following an adverse finding by the Competition Commission during the course of its quinquennial price control inquiry. Additionally, the CAA can set conditions to remedy unreasonably discriminatory or exploitative conduct by an airport.

⁵⁴ Airport Development and Investment Ltd, a financial consortium comprising Grupo Ferrovial, Caisse de dépôt et placement du Québec and Baker Street Investment.

⁵⁵ BAA Ltd: A report on the economic regulation of the London airports companies (Heathrow Airport Ltd and Gatwick Airport Ltd), Competition Commission, October 2007.

⁵⁶ Capital investment in the five years 2003–04 to 2007–08 is expected to be around £5.4 billion and £0.5 billion respectively. (Figures from the Competition Commission's October 2007 report).

⁵⁷ Pier service is measured as the proportion of flights where passengers embark and disembark directly from the terminal piers, rather than are transported by bus between the aircraft and terminal.

13. The Competition Commission very largely endorsed these investment plans, and has proposed a rate of return for each airport which it considers should be adequate to encourage debt and equity investors to commit capital to BAA. Given the importance of timely delivery of the capacity and service provision which this investment should provide to users, the Commission also advocated a comprehensive array of financial penalties on each airport for delay in achieving project milestones. One of the challenges for the CAA in making its price control decisions for Heathrow and Gatwick⁵⁸ will be setting appropriately testing targets and financial incentives on BAA to deliver robust investment plans at each airport. The greater challenge for BAA will be to implement these plans through the timely delivery of a complex series of capital projects.

14. Investment provides the platform for BAA's service performance. In many areas, when facilities are operated beyond their planned capacities (because of planning delays in new capacity coming through) service standards suffer. This is particularly so when the airports face a shock, as they did in 2006 from more severe security requirements. Nevertheless, it remains BAA's responsibility to plan carefully and to manage its resources efficiently to deliver consistently good service standards to passengers and airlines. The financial incentives which the CAA introduced in its 2003 regulatory settlement have had a positive effect in sharpening BAA's focus on bringing service standards in general over the past five years up to an acceptable level. The Competition Commission found though that BAA's performance in maintaining security processing standards (albeit in the face of some substantial external pressures since early 2006) was not adequate.

15. The CAA has already signalled its intention of raising and broadening service standards in this and other areas, and increasing the financial incentives on BAA to meet the higher targets. Where higher standards entail greater costs (for example to deliver the Government's more exacting passenger search requirements), then CAA will also make appropriate provision for these costs in setting airport charges. It will remain BAA's primary responsibility and challenge, though, to run its operations efficiently and effectively (including resilience in the face of shocks), to maintain passenger security, and to improve passenger experience. The CAA's role is to set the right combination of standards and financial incentives on each airport to encourage the delivery of the service which passengers and airlines rightly expect.

16. Looking more generally at BAA's operation of Heathrow and Gatwick in the coming years, the CAA's advice to the CC and the CC's recommendations back to the CAA both concurred that BAA should be able to run its operations more efficiently (and at the same time improve its service performance), than proposed by the company itself. The CAA will be setting the Heathrow and Gatwick airport charges in the next few months in line with its statutory duties and in light of the evidence from the CC and extensive analysis and consultation. BAA's challenge will be to live within the regulatory settlement and to respond positively to the regulatory and commercial incentives towards renewing and expanding airport infrastructure and improving passenger service.

Economic regulation of Stansted airport

17. At Stansted, the CAA has identified that competition places sufficiently effective dynamic disciplines on BAA's behaviour. It has therefore advised the Government that Stansted Airport should be de-designated, with price cap regulation therefore removed from the airport. This would mean that users of the airport were protected by the combination of competition, competition law and some, more limited, sectoral regulation. In its advice, the CAA highlighted that continued price cap regulation risked distorting the airport's incentives to undertake investment in new facilities and, as a result, undermining the effective interaction between airlines and the airport. De-designation would enable the development of normal commercial relationships with BAA setting future investment plans in light of market signals rather than the necessarily distorting regulatory regime.

18. The Government is currently considering the responses to its consultation on the de-designation of Stansted and is expected to announce its decision towards the end of the year.

FUTURE CHANGES TO THE ECONOMIC REGULATORY FRAMEWORK

19. As noted above, there is significant scope for the economic regulatory framework to be modified in future. This could be an outcome of the CC's market inquiry into BAA or as a consequence of the Government's recently announced strategic review of the CAA.

20. For so long as the current regime remains in place, the CAA must exercise its statutory duties in accordance with its functions and duties. However, the CAA is prepared to participate in any debate about changes to the regime.

21. In written evidence to the House of Lords Committee on Regulators submitted in February 2007, the CAA has made clear its openness to the reform of a number of specific aspects of the current framework including whether:

- the CAA should have the power to designate or de-designate airports for price control purposes;

⁵⁸ CAA final decisions expected by March 2008.

- the CAA’s concurrent powers to apply competition law should be extended to encompass airports as well as air traffic control services; and
- there should be an automatic five yearly reference to the CC.

22. In written evidence to the CC’s market inquiry submitted September 2007, the CAA also drew attention to a number of fundamental issues that it would expect the CC to weigh up in arriving at its view as to the most appropriate future economic regulatory regime. In particular, the CAA highlighted the importance of considering:

- the link between competition and the appropriate nature of economic regulation;
- the degree to which the airports sector might be characterised by natural monopoly; and
- the differences between the airports sector and other sectors subject to economic regulation.

THE STRUCTURE OF THE AIRPORTS MARKET

23. The CAA has made two submissions to the CC’s market inquiry,⁵⁹ drawing on the analysis undertaken in fulfilling its regulatory functions. The CAA expects to contribute further to the CC’s detailed two year inquiry.

24. As the CAA set out in its first submission to the CC, there is in general considerable evidence that airports can, and do, compete for passengers and for airline business. In recent years, a number of regional airports (for example, Liverpool, Prestwick and East Midlands) have successfully attracted passengers and airlines and have experienced rapid growth in their businesses. Furthermore, the OFT has cited evidence that Glasgow and Prestwick airports compete for passengers and airlines.

25. The CAA has considered both the extent of interaction between the London airports, and between them and a number of regional airports, and has concluded that there are material interactions in both cases. However, there are a number of features of the airport market, particularly in the southeast of England, including the operation of the planning regime or airspace constraints, that might constrain the degree to which airports effectively compete and, therefore, potentially limit the benefits that might otherwise be expected to accrue from competition—factors that the CC will no doubt wish to consider in its work.

CONCLUSION

26. The CAA is grateful for the opportunity to submit written evidence to the Committee. The continuing CAA review of price controls at Heathrow and Gatwick, the Government’s decision on whether Stansted should remain designated and the CC’s market inquiry will all have significant implications for BAA. However, its most immediate challenge is the delivery of investment and operational performance at its airports. BAA’s efforts in these areas will be important, but the performance of the airport overall from the perspective of the passenger depends crucially on the effectiveness of—and co-ordination between—all the players whose activities affect the airport. The CAA believes that there should be greater information—and transparency—about the performance of different parties and will be addressing that matter in its proposals for Heathrow and Gatwick.

November 2007

Memorandum from the Independent Airport Park and Ride Association (IAPRA) (BAA 27)

SUMMARY

1. The Independent Airport Park and Ride Association (IAPRA) is pleased to submit evidence to the Transport Select Committee’s inquiry into the future of BAA.

2. IAPRA is the trade association representing the UK’s independent off-airport park and ride industry. It was established in 2002 to promote security measures and high standards of customer service in the off-airport park and ride industry, and to ensure that the role of the industry is fully understood and properly reflected in the development plans for UK airports and their associated surface access strategies. IAPRA’s members are long-established and highly reputable professional companies with loyal customer bases.

3. Our members’ combined 45,000 car parking spaces serve several million passengers travelling to and from airports the length and breadth of the UK each year. These include the BAA-owned airports at Aberdeen, Edinburgh, Gatwick, Glasgow and Heathrow.

4. The key points of our submission are:

⁵⁹ The CAA submitted a response to the CC’s Statement of Issues in September 2007 and to the CC’s call for evidence in May 2007.

- The future of BAA is not simply an issue of airport ownership or services provided to airlines. The ancillary services provided to airport users and passengers, including airport-related car parking, are critical to the overall operation of airports and as such merit attention by the Committee within this inquiry;
- As BAA's airports expand to cater for increasing numbers of passengers, it is vital that adequate car parking capacity is provided to meet increasing demand, in tandem with improvements to public transport links;
- A significant proportion of people travelling to airports will continue to have little option but to drive to an airport and park, in spite of public transport improvements, and it is vital that they are able to access a genuine choice of legal, secure and competitively-priced car parking services;
- IAPRA members who serve passengers using BAA airports have, however, persistently experienced difficulties in competing fairly with BAA's own car parking facilities; and
- The monopolistic behaviour of BAA in the provision of car parking must be addressed to ensure that an appropriate and competitive mix of on and off-airport parking is available to passengers driving to airports. The various remedies that IAPRA proposes to facilitate such a mix should extend beyond BAA to all UK airports.

BACKGROUND

5. While IAPRA agrees in principle with the government's policy objective to encourage people to travel to airports by public transport as much as possible, it will be extremely challenging for most airports to increase public transport's modal share without a huge increase in government funding for public transport, which seems unlikely at present.

6. The private car is likely to remain the preferred method of travel for a significant proportion of passengers for a variety of reasons, including: lack of proximity to public transport services; poor public transport services outside of daylight hours; the inconvenience of public transport, particularly for larger families travelling with baggage and the disabled; and the cost of services. For many people, public transport will remain an unviable option, despite efforts to improve public transport links to airports.

7. Notwithstanding that an increase in the public transport modal share for passengers travelling to airports may be achieved, the anticipated increase in passenger numbers at BAA's airports will in any case result in an overall increase in the number of passengers travelling to airport by car, which in turn will result in an increased demand for airport car parking.

8. The provision of a genuine mix of on and off-airport car parking services is therefore vital, and in the public interest. A proper provision of fully-authorized, independently-owned off-airport park and ride facilities, alongside the on and off-airport car parks controlled by BAA, keeps the cost of airport parking competitive.

9. This in turn helps to tackle some of the unhelpful behaviours caused by more expensive parking, such as excessive use of taxis and "kiss and fly" journeys, along with the growing problem of illegal or rogue airport-related parking—often involving cars being parked on roadsides or at sites without appropriate planning permission, many of which also fall a long way short of the standards of service and security that prevail in the legitimate parking market and are required of IAPRA members.

POLICY ISSUES AND CONCERNS

10. BAA is an exceptional, possibly unique, UK monopoly. As a "conventional" monopoly it has a dominant share of air passenger traffic. Locally it has an absolute monopoly of airport forecourt facilities and of on-airport parking. BAA's market share of on- and off-airport parking across all of its airports is 72%, while at Stansted it is 98%.

11. BAA's "conventional" monopoly is enhanced by statutory and quasi administrative powers:-

- The Airports Act gives BAA the right to make byelaws;
- The Road Traffic Regulation Act gives BAA power to make traffic regulation orders;
- BAA can use compulsory purchase powers to acquire land for airport expansion;
- Permitted development rights give BAA rights to develop and change the use of land and buildings on its airports;
- As a highway authority, BAA consults with neighbouring highway authorities to develop transport plans which favour its own business development; and
- The Air Transport White Paper requires airport operators to prepare plans and identify land for airport expansion. Local planning authorities are obliged to safeguard land for such expansion.

12. An overwhelmingly dominant supplier with statutory and quasi-administrative powers will use those powers for its own commercial interests. This has, in IAPRA members' experience, been the case at a number of BAA airports.

EXAMPLES OF ABUSE BY BAA

13. BAA has an inherent competitive advantage over its airport parking competitors as a result of a number of factors: its monopoly of airport forecourt facilities and dominance of airport parking supply; its ability to brand its parking as “Official” and market it on the airport web sites; and the increased cost base of off-airport car parks arising from transportation costs and charges levied by BAA for use of its forecourt facilities.

14. BAA enhances this competitive advantage by systematic abuse of its dominant position and exercise of its statutory and quasi administrative powers. These abuses include:

Preferential Facilities

15. An airport operator which did not compete in downstream markets would naturally provide a single drop-off/pick-up facility for the different categories of airport forecourt users. BAA, on the other hand, provides different drop-off and pick-up facilities for on and off-airport car parking services. It allocates facilities in prime positions for its own BAA-owned car parks and facilities in secondary positions for rival off-airport competitors including IAPRA members.

Excessive Charging and Lack of Transparency

16. The licence fees that airport operators have attempted, and continue to attempt, to charge IAPRA members for the use of forecourt facilities is a recurring theme for those of our members that serve BAA airports and their passengers.

17. IAPRA is of the firm view that the charges levied by airport operators for licences allowing our members to use facilities to drop off and pick up passengers and their luggage on airport forecourts should be on a strict cost-recovery basis, inclusive of agreed levels of return on capital employed and revenue expenditure.

18. While we accept that the basis upon which costs are shared between users of shared facilities can vary dependent upon what is reasonable, having regard to the facilities and particular circumstances at each airport, it is essential that the costs and income related to the facilities provided are transparent. It is also vital that, in the case of a potential dispute, BAA’s costs and income relating to these facilities are capable of independent verification.

19. BAA confirmed to the Monopolies and Mergers Commission, in evidence for the 1991 Quinquennial Review, that licence fees for bus and coach services should be based on the recovery of costs directly related to dedicated facilities. However, BAA has repeatedly proposed fees for use of forecourt facilities which IAPRA members, without the benefit of income and expenditure transparency statements, believe to be excessive.

Use of Byelaws and Traffic Regulation Orders for BAA’s commercial advantage

20. Byelaws should not be made in restraint of trade or for commercial gain. However, an airport operator is in the position of having the power to make byelaws and traffic regulation orders affecting the roads and forecourts at its airport, while also being the owner of car and coach parks—for which parking charges are usually levied—at which airport users will need to park in the event that they are prohibited from dropping off or collecting passengers on the airport roads free of charge.

21. Byelaws and traffic regulation orders have also been used by BAA to direct coaches operated by its competitors to use less advantageous facilities. It appears to IAPRA that BAA uses these powers to provide it with a sanction to enforce its own discriminatory and anti-competitive conduct.

Planning and Compulsory Purchase

22. Compulsory purchase powers are used to acquire land for public infrastructure works and to enable major development schemes in the public interest to proceed. However, BAA has carried out commercial development, not related to its airports, on land which was acquired under compulsory purchase powers. BAA also extends the use of compulsory purchase powers to acquire land for airport-related uses, including car parking, which could be provided by off-airport operators. The favourable terms upon which land is compulsorily acquired means that BAA is able to acquire land far cheaper than its off-airport competitors, who do not enjoy the same compulsory purchase powers.

Master Plans and Airport Expansion

23. The Government's requirement that airport operators such as BAA must prepare master plans tilts the planning process in favour of on-airport development. Planning authorities, who may be against airport and airport-related development, are required to protect land for the expansion which the airport operator proposes. Once land is within a designated airport boundary, the airport operator uses permitted development rights to change the use of land and buildings from airport use to airport-related commercial uses.

24. In our experience, most master plans, including some of those proposed by BAA airports, have made it clear that additional parking required to accommodate growth will be provided through on-airport parking alone, with no allowance made for independent off-airport parking facilities. We find this approach highly anti-competitive, and fail to see how it can be in the interests of the consumer.

25. IAPRA is concerned that the master plan process effectively allows a monopolistic organisation—an airport—to be both judge and jury over the content of its master plan with no independent assessment and approval mechanism. Once a master plan is finalised, it will be very difficult for any independent parking operator to get planning permission for an off-airport parking site in the future.

26. Compulsory purchase powers, combined with the way that airport master plans are prepared, leads to most airport-related development taking place within the airport's boundaries, where the airport operator can develop for its own commercial gain at the expense of consumer choice and competition.

Trade Mark Abuse

27. By registering airport names as trade marks BAA claims the exclusive right to market the services protected by its registration under the airport name. For example, parking serving Heathrow Airport has for many years been described and marketed as "Heathrow Parking" by operators on and off the Airport. Notwithstanding this historic use of a geographic place name, which is not distinctive of BAA's services, BAA has attempted to claim for itself the exclusive right to use this and similar trade names.

POSSIBLE SOLUTIONS

28. In our view, the possibility that BAA is required to dispose of one or more of its airports as a result of the Competition Commission's current inquiry would do little to prevent BAA continuing to abuse its local monopoly of forecourt facilities and dominance of parking at airports which it retains. IAPRA members have experienced monopolistic behaviour at both BAA and non-BAA airports. Any restrictions imposed on BAA in respect of its airport operations should apply to all airport operators.

29. BAA or any other airport operator's control of authorised airport parking should not, in our view, exceed an appropriate percentage of the total market. In cases where the appropriate percentage is exceeded, the airport operator should be required to lease or sell a proportion of its parking to an unrelated company.

30. Common forecourt facilities should be provided for each category of forecourt user. For example, the same coach bays should be used by vehicles serving both on and off-airport car parks. Furthermore, the charges for forecourt facilities should be on a cost-recovery basis, and airport operators should be obliged to provide income and expenditure transparency statements for the use of such facilities.

31. We do not believe there should be a policy in favour of all landside airport-related development, including car parking, being located on-airport. Planning authorities could then consider whether the most appropriate location for such development is on or off-airport. Permitted development rights should not extend to airport-related development, and compulsory purchase powers should only be exercised for acquiring land for runways and other airside facilities.

32. Each UK airport should, in our view, have an Airport Users Consultation Committee, (in place of the non-statutory Transport Forums) with which the airport operator would be obliged to consult on issues including master plans, traffic strategies, byelaws, and Traffic Regulation Orders. This should encompass all main airport users, including off-airport park and ride operators, in addition to local authorities, and representatives of leisure and business travellers.

CONCLUSION

33. IAPRA is keen to ensure that the debate about the future of BAA extends beyond questions of airport ownership and the experiences of airlines operating from BAA's airports.

34. Anti-competitive and monopolistic behaviour on the part of BAA is, in our view, evident in the provision of airport car parking. There is no reason why BAA, or indeed non-BAA airport owners, should have a monopoly in the provision of airport car parking, or other ancillary airport services. Such services can easily be provided by independently-owned third parties on a competitive basis, with the benefits of competition flowing to airport passengers in the form of more choice, more competitive pricing and better service.

35. In environmental terms, after public transport we believe that travelling to airports by private car and parking in off-site long term car parks should be the preferred choice for airport passengers—and facilitated as such by public policy. It has the real potential, if harnessed and encouraged appropriately by policy makers, to make a significant impact in reducing the number of taxi and kiss and fly car movements at airport terminals.

36. IAPRA has been engaging with the Competition Commission in the context of its current market investigation into the supply of airport services by BAA. We were encouraged that the Commission's Issues Statement indicated that it will be looking further at the issue of airport parking provision. We are looking forward to further dialogue with the Commission on our concerns.

37. It is very welcome that the Transport Committee is also focusing on the important issue of the future of BAA, and IAPRA hopes that the inquiry will serve to focus attention on some of the important public policy issues raised in our submission.

November 2007

Memorandum from Virgin Atlantic Airways (BAA 28)

INTRODUCTION

1. Virgin Atlantic is pleased to submit evidence to the House of Commons Transport Committee inquiry into the future of BAA. Virgin Atlantic operates 37 aircraft to 30 long-haul destinations worldwide, with 27 of these routes originating from BAA-owned airports in the UK. The majority of Virgin Atlantic's long-haul services are operated from two of BAA's South East airports, Heathrow and Gatwick, with a limited operation from Glasgow.

OVERVIEW

2. Several recent Government reports have confirmed that the performances of BAA's London airports, in particular Heathrow, are vital to the continued competitiveness of London as a world financial centre.

3. However, over many years BAA's customers have experienced falling service quality standards and inefficiency, alongside a lack of investment or unsuitable investment that is inappropriate to customer needs. There can be little doubt that the continued inefficient operation of these airports is a threat to the UK's economic performance and international competitiveness.

4. It is Virgin Atlantic's belief that the consequences endured by BAA's customers (the airlines) and our passengers are a direct outcome of two challenges:

- (a) the lack of competition in the provision of airport services in the South East of England and;
- (b) the behaviour of BAA as a monopoly provider alongside an imperfect regulatory system.

These facets interact to produce results that act to the detriment of BAA's customers, passengers and UK plc.

5. We believe that it is timely to investigate these challenges more closely and employ appropriate remedies. As such Virgin Atlantic supports the investigation by the Competition Commission into the break-up of BAA's monopoly control over the South East of England's airports and presses for continued, indeed enhanced, regulatory oversight of these airports.

- (a) *BAA's monopoly supply of airport services in the South East of England*

6. For Virgin Atlantic, it is essential that the monopolised ownership structure of airport capacity in the South East of England is addressed to correct some of the problems we experience in operating from Heathrow and Gatwick. BAA owns four airports in the region accounting for in excess of 90% of the passenger market.

7. Virgin Atlantic welcomes the Competition Commission's inquiry into the broad range of structural remedies that can be implemented to maximise competition and its benefits, and restrict BAA's (or any other organisation's) ability to prevent, restrict or distort competition to the detriment of airport passengers and users. We believe that both airlines and passengers should be able to benefit from increased competition in the airport sector, as has occurred through liberalisation of the airline industry. The most stringent of these remedies is necessary to protect airlines and passengers from BAA's ability to exploit its market power.

8. We see no significant economic benefit from the joint ownership of Heathrow, Gatwick and Stansted by BAA, and believe it timely that a comprehensive review of whether the current portfolio of airports that BAA holds in the South East of England is in the public interest. Virgin Atlantic advocates the divestment of one or more of BAA's South East airports, alongside continued economic regulation, to maximise competition and its associated benefits.

9. Virgin Atlantic recognises the need to correct the ownership structure of the airports in the South East of England. However, we wish to reiterate that even if the Competition Commission were to recommend divestment of BAA's assets, in whatever form this might take, this does not mitigate the need for economic regulation of each airport. Heathrow and Gatwick in particular would continue to exercise significant monopoly power even if separately owned. Despite the shortcomings of the current economic regulatory system, it is the only protection mechanism available to airport users and one that we wish to see maintained, indeed enhanced, to protect users.

10. Virgin Atlantic welcomed the Office of Fair Trading's referral of the ownership structure of the BAA airports in the South East of England to the Competition Commission. We recognise the negative consequences of the monopolised nature of the existing ownership structure and believe that this operates against the public's interest.

(b) BAA's monopolistic behaviour and the imperfect functioning of the regulatory system

11. Two features characterise the behaviour of a monopolist: a firm's ability to raise price and/or its ability to restrict output below the optimal level. Neither of these outcomes are unfamiliar to the users of airports operated by BAA.

(i) *Prices*

12. During the past five years BAA's customers have experienced increasing prices in operating from Heathrow and Gatwick. An extremely favourable regulatory settlement granted by the CAA to BAA in 2003 looks set to be repeated during the next quinquennium. Currently, there is a recommendation by the Competition Commission to permit Heathrow to raise its prices by RPI + 7.5% that would result in price rises of some 50% over the next five years.

(ii) *Outputs*

13. Against this background, BAA's customers have borne the consequences of poor service quality standards and inefficiency, alongside a lack of investment or unsuitable investment that is inappropriate to customer needs.

SERVICE QUALITY

14. During the past year in particular, it has been difficult to escape the media attention that BAA has received in terms of passenger experience and service delivery. However, it is important to note that criticisms of BAA's service quality standards have been present for a number of years and well in advance of the current increased security requirements. In addition, these criticisms concerned far more than just security standards.

15. Nevertheless, the security emergency of August 2006 served to highlight many of BAA's deficiencies. The emergency was unexpected and affected both airports and airlines. Nobody can blame BAA for the initial problems experienced. However, the airlines quickly adjusted to the new situation; BAA did not. It is totally unacceptable that at Gatwick, for example, security queues can still frequently snake through the South Terminal, many months after August 2006's emergency.

16. Although well publicised, poor service quality provision by BAA is not restricted to central search alone. Virgin Atlantic's customers receive poor service quality standards across a wide range of services provided by the airports. It has been obvious to the airlines for some time, and noted to the CAA, that there is an apparent discrepancy between the standards reportedly achieved by BAA, for example in the provision of seating, escalators, moving walkways, lifts, etc, and the experience of our customers.

17. It is unacceptable that the regulatory systems' proposed remedy to these issues is to reward BAA with more revenue by permitting it to raise prices in excess of RPI. To do so would delay correcting the fundamental cause of the problem as it reduces the pressure on BAA to change its business model and its operational processes and become a more customer-focussed organisation.

18. The Service Quality Regime (set up in 2003 in response to the Competition Commission's public interest finding to redress BAA's poor service quality provision) exposes BAA to a penalty of 3% of the airport charges, should BAA default on the standards set. For the year ending April 2007, BAA was forced to pay back to airlines only £1,063,592 at Heathrow and £589,881 at Gatwick. This rebate represented just 0.18% and 0.37% respectively of Heathrow and Gatwick's revenues from charges. This was at a time when BAA was subject to considerable public criticism for its service standards.

19. It is not hard to conclude that these percentages are insufficient to motivate the airports to deliver, let alone exceed, the agreed standards. This is quite different from the competitive environment within which the airlines operate. Airlines are exposed to the full risk of poor service quality, as customers have the option of voting with their feet.

20. Virgin Atlantic welcomed the Competition Commission's public interest finding against BAA in 2003, and recognises the benefits of the introduction of the service quality regime. However, in our view this regime does not go far enough. Its failure to expose BAA to a significant enough penalty if standards are not met and it fails to incentivise BAA to become more customer-focussed as would be expected in a competitive environment. For airlines, the scheme is further weakened by BAA's ability to request a suspension of the

scheme. For example, following the security events of 10 August 2006, the service quality rebate scheme was suspended in relation to security queuing. To ensure the scheme imposes the right incentives on BAA to become more customer focussed, the service quality rebate scheme needs to expose BAA to increased penalties for failure to achieve agreed standards, cover a much wider scope of measures, and be independently measured and audited.

OPERATIONAL EFFICIENCY

21. Fundamental to the CAA's regulatory task is the requirement to reach a view on the level of operational expenditure that BAA should achieve, similar to what a competent, well-managed company would be expected to achieve. The CAA's approach to determining the appropriate expenditure level of BAA is to extrapolate current performance and apply an efficiency assumption to proxy the performance of a well-managed company.

22. There are several flaws in this approach. Experience from the last five years indicates that the airports are not well managed, therefore extrapolating from this base inflates the assumption of operational expenditure for the next regulatory settlement. Secondly, the CAA's efficiency assumptions for operational expenditure are barely testing or reflective of what could be expected of a well-managed efficient company. In its initial assumptions the CAA has assumed an efficiency factor of 1%, significantly short of the efficiency gains achievable if the airport operator was forced to change its business model and become more customer-focussed and cost conscious. In comparison to the CAA's 1% efficiency assumption, in the competitive airline industry IATA estimates that since 2001 airlines have achieved non-fuel unit cost savings of some 13%.

23. The regulatory system fails to pressurise BAA to explore alternative methods of service provision that could reduce operational expenditure and increase the standard of service provided. BAA's monopoly of service provision within the airports it owns often leads to alternative management and procurement methods not being explored, with the consequence of spiralling operational expenditure. In numerous submissions, Virgin Atlantic has specified several areas where alternative suppliers and competitive tendering of services within the airport could improve efficiency.

24. The benefits of competitive tendering are far reaching: reduced costs, better alignment of service standards to customer needs, innovative approaches to service delivery leading to increased efficiencies and greater transparency. By failing to pressurise BAA to explore alternative delivery methods, the consequences of airport service provision by a monopoly supplier become self-perpetuating, with the airport's customers and their passengers bearing the costs of inefficiency, poor management and bureaucratic business processes whilst continuing to endure poor service standards.

INVESTMENT

25. The regulatory system also fails to motivate BAA to undertake appropriate, timely investment to the benefit of its customers. Volume based charging incentivises BAA to "sweat" airport assets, by operating at the limit of capacity. The result is that investment is not forthcoming leading to overcrowding, delays, inefficiency and the need for more redundancy in airline schedules. The resultant congestion costs are transferred directly onto the airport users. BAA's typical response is to blame the planning system. Virgin Atlantic accepts that the planning system acts as a constraint, but to blame it for all the problems at Heathrow and Gatwick is to ignore the failure of BAA to take pre-emptive action.

26. The future of Virgin Atlantic depends to a very significant extent on our ability to operate cost effectively and efficiently out of Heathrow and Gatwick, while offering a high standard of service quality. The current regulatory regime fails to incentivise BAA sufficiently to deliver these same goals for the benefit of the airport users and passengers it is designed to protect. Virgin Atlantic believes it is now appropriate to identify the shortcomings of the current regulatory system, and develop solutions to ensure that these outcomes are not perpetuated.

Conclusion

27. It is Virgin Atlantic's belief that it is not inevitable that Britain's two largest airports should perform so poorly. They do so as a function of the continuation of BAA's monopoly supply of airport services, particularly in the South East of England, but also as a consequence of an imperfect regulatory system.

November 2007

Memorandum from the Office of the City Remembrancer (BAA 29)

This letter responds to the Committee's announcement of plans for an inquiry into the future of BAA. I thought it appropriate to use this opportunity to set out a number of concerns recently voiced by City businesses over the situation at Heathrow.

As I am sure the Committee will acknowledge, good aviation services and efficient welcoming airports are a critical contributory factor to the continued competitiveness of the City of London as the world's foremost financial and business centre and therefore, also to the ongoing success of the UK economy. Research undertaken for the City Corporation in 2002⁶⁰ showed that 70% of firms considered air services to be critical for business travel by their staff and 50% of respondents considered air travel critical for travel by their clients to meet them. Perhaps not surprisingly, the survey underlined the importance of Heathrow to companies in London with over 90% considering it to be the most important airport for their business travel, and 75% considering it to be critical.

This research demonstrated that the importance of air services to businesses in central London, and particularly within the Square Mile, is arguably more pronounced than in the rest of the UK. This can perhaps be explained by the high concentration of international firms, particularly those in the financial and business related services sector which, on average, tend to spend much more on air services than the UK business average.

Business respondents to the survey identified better surface access to London's airports as the most the important improvement they would like to see. The opening of the Docklands Light Railway to City Airport and the recent funding approvals for Crossrail and Thameslink have now signalled that prospects for the relief of this problem are good.

The research also showed that London companies were very concerned about the time they considered wasted at airports because of the length of check-in queues, time taken for security checks, delays to flights, and so on. Whilst the importance of thorough security arrangements is wholly accepted, it is very expensive for companies to have staff unable to work because of costly delays in the travel system. Interestingly, one of the companies interviewed for the research emphasised that improved surface access and more streamlined airport procedures such as, for example, more remote check-in, could lead to substantial improvement in the quality London companies' experience of air services with no environmental cost.

It should be acknowledged that since the research was completed there have been some improvements to procedures with, among other changes, the expansion of on-line check-in facilities. The heightened security threat worldwide, together with a general increase in the number of air travellers, has however served to negate these benefits. This has been a particular concern for the business community recently and there is frustration that nobody in Government is taking full ownership of the problem because it cuts across a number of Whitehall departments.

The City Corporation shares the concerns of businesses that conditions at Heathrow, in particular, present a poor image for the UK and, unless improved, may impact on the attractiveness of London as a place for inward investment. The City Corporation recently published its Global Financial Centres Index 2⁶¹ which rates the competitiveness of the world's top 50 financial centres. The report points out that whilst London has maintained its slight lead over New York in all five areas of competitiveness (people, business environment, market access, infrastructure and general competitiveness) there are growing concerns over London's ageing infrastructure, with many survey respondents pointing out that failure to address overcrowding, high prices, and delays in the system are tarnishing London's reputation.

There are clear arguments that, in order to maintain competitiveness, action must be taken to address public transport infrastructure and aviation hubs. Some have suggested that introducing allowances for two carry-on bags at Heathrow and increased security staff numbers would go some way to alleviating the problem in the eyes of business travellers. A further report published by the City⁶² maintains that investment in public services and infrastructure such as airports is vital if the London economy is to continue to be successful. The opening of Terminal 5 should provide the opportunity to significantly improve the travel experience for those passengers who use the new terminal. This will however require adequate staffing levels and the introduction of appropriate streamlined procedures to minimise delays at check-in, passport control and security checks. In addition, much work will still be needed to bring the remaining terminals at Heathrow up to modern standards and to ensure that facilities at Gatwick and Stansted keep pace with demand.

If you have any further queries in connection with the City's interests in this topic, please do not hesitate to contact Bruce Hunt in my Office who has been responsible for the preparation of this submission.

November 2007

⁶⁰ *Aviation Services for the City of London*, Oxford Economic Forecasting and The Aviation and Travel Consultancy, published by the City of London Corporation, October 2002.

⁶¹ *The Global Financial Centres Index (GFCI) 2*, Z/Yen Group Limited, published by the City of London Corporation, September 2007.

⁶² *London's Place in the UK Economy 2007-08*, Oxford Economics, published by the City of London Corporation, October 2007.

Memorandum from easyJet Airline Company Ltd (BAA 30)

easyJet is a low-cost scheduled airline and is now the UK's largest airline both in terms of passengers carried and flights operated. easyJet has flown over 37 million passengers across Europe in the last 12 months. easyJet is the third largest user of BAA's airports and the third largest user of BAA South East airports in terms of passenger numbers. easyJet operates from the following BAA airports: London Gatwick, London Stansted, Edinburgh, Glasgow, Aberdeen and Naples. easyJet has a significant interest in the successful operation of BAA's airports, both in terms of their efficiency and their quality of service.

EXECUTIVE SUMMARY

easyJet is strongly of the view that the CAA's regime for economic regulation needs reforming. Indeed, BAA is in a position of market power, and its ability to maintain its profitability despite delivering poor service quality is failure of the regulatory regime. Although BAA's profits fell in 2006/7, BAA achieved an operating profit margin "before certain re-measurements"⁶³ of 32.2% (compared to easyJet's 7.3% and BA's 6.5% operating margin profit for the last financial year).

easyJet is concerned with the future of airports in the South East and our focus is on achieving an airport market structure, supported by regulation, that encourages competition wherever possible. The break-up of BAA's South East airports will not on its own achieve this because each airport will still be a local monopoly. easyJet believes that the solution instead lies in increasing the level of competition within airports, and introducing innovative regulatory tools that incentivise the right kinds of investment and behaviour.

This paper sets out easyJet's written evidence for this inquiry:

1. easyJet welcomes the Committee's inquiry into the future of BAA. The proposed runway expansion of Heathrow and Stansted is important to the future market structure of South East airports. In addition, the concerns identified by the Office of Fair Trading (OFT) over BAA's market power and those of the Competition Commission over BAA's service quality delivery are shared by easyJet.

2. The Department for Transport (DfT) is also currently considering the case for the de-designation of Stansted, which easyJet firmly opposes. The de-designation of Stansted would allow BAA to use its market power to increase prices and reduce service quality. easyJet has submitted evidence to the DfT demonstrating that price controls must be retained at Stansted to safeguard passengers and airlines from BAA's market power. easyJet's evidence was accompanied by a detailed report from Frontier Economics setting out the failures in the analysis provided by the Economic Regulation Group of the CAA.⁶⁴

3. For the record, easyJet would like to make clear that its concerns with BAA lie principally with the operation of BAA airports as opposed to BAA's corporate structure.

THE FUTURE OF BAA

4. easyJet wants to operate from airports that are as competitive as possible, and that provide the service that customers want. This section outlines easyJet's suggested way forward.

The need for new capacity

5. There is general agreement that new capacity is needed in the South East, and that this is likely to take different forms at different airports. The need for new capacity should not be seen as justifying existing service quality failings. The evidence from the Competition Commission suggests that the current failings of BAA are not simply due to capacity constraints, but also reflect inefficient management of existing capacity. Many of the existing failings could be rectified without significant new increases in capacity. For example, security posts at Stansted remained undermanned for much of the second half of 2006.

6. easyJet does not believe that new investment will resolve the problems at BAA's airports. The suggestions from BAA that it needs a generous regulatory settlement from the regulator to fund new investment, and also its future financing needs, demonstrate how BAA is treating the new investment as a source of future profit, rather than a way in which to reduce service quality weaknesses.

The need for competitive airports

7. Without competition it will remain a challenge to ensure that airports are efficient and deliver a reasonable quality of service. It is unlikely that there will be sufficient growth in capacity across the South East in the next few years to deliver competition between airports. However, given the size of BAA's South East airports, and the expansion that may take place, easyJet believes that there may be room to consider whether more competition can be introduced for airport services at each airport.

⁶³ See BAA results, announced on 14 November 2007: <http://www.baa.com/assets/B2CPortal/Static%20Files/BAA30Sept%202007InterimResults.pdf>

⁶⁴ This report is publicly available at <http://www.frontier-economics.com/europe/en/publications/150/>

8. Any expansion of the competition for airport services will need to be consistent with the regulatory structure, which we believe will need to be reformed to improve service delivery, but also to manage new investment.

The potential break-up of BAA

9. The Competition Commission is currently considering the case for the break-up of BAA. easyJet believes that break-up itself will not change the underlying lack of competition in the South East, which is due to the monopoly position each airport holds in its catchment area. BAA's South East airports will continue to need regulation, whether or not they are individually owned.

10. BAA's monopoly position derives from:

- (a) Passengers wishing to travel from their local airport (and thereby reduce surface transport congestion),
- (b) The lack of spare capacity at any South East airport.

11. easyJet has provided evidence to the OFT, CAA and the DfT on these issues, in response to their respective consultations on BAA and the de-designation of Stansted.

The future regulatory framework

12. The regulation of airports has been successful in constraining BAA's ability to increase prices. But it has been less successful at ensuring the efficient operations of airports and incentivising the right kinds of investment.

13. Regulatory Asset Base (RAB) regulation does not work well for large or lumpy investment, and dictates price paths that are inconsistent with those that would be expected in a competitive market. For example, under RAB regulation, prices charged by an airport increase significantly when new investment is undertaken, and then fall over time as passenger numbers increase. However in a competitive market, we would expect to see the reverse pattern.

14. Coupled to this is the failure of the regulatory structure to deliver investment agreed by both airlines and the airport. This is not only a problem at Stansted, many different airlines complain about the levels and types of investment by BAA at all its South-East airports. No real incentives are placed on airports to reach agreement with their customers, as they have market power over them, and the regulator has been unwilling to determine investment levels.

15. Finally, existing regulation has failed to deliver adequate service quality. This is both a result of BAA's market power, and of the lack of the right incentives placed on BAA to deliver appropriate levels of quality. It is apparent that over the past five years the CAA has presided at arms length over a steady decline in service quality at BAA's airports, in spite of its introduction of a scheme to address the issue, and the undertakings given by BAA at the last review. It is clear that for service quality to improve, BAA must perceive some level of threat that it will be punished for failure. To lack of punishment for BAA failure is manifest, not least by BAA's unilateral suspension of the CAA's security queuing element of the service quality rebate scheme in August 2006, which is further compounded by the CAA's decision to allow this. The current service quality rebate scheme places 3% of BAA's charges revenue at risk; however, this has failed to place adequate incentives on BAA. In October this year, the Competition Commission recommended that these sums at risk be increased to between 5% and 10%.

November 2007

Supplementary memorandum submitted by easyJet Airline Company Ltd (BAA 30a)

THE POTENTIAL BREAK-UP OF BAA & THE LACK OF SPARE CAPACITY IN THE SOUTH-EAST

easyJet believes that each of BAA's three London airports has market power, and that this market power is not dependent on BAA's joint ownership of the airports. easyJet supports the break-up of BAA's South East airports, but believes that this should not be at the expense of an effective regulatory structure for the three London airports.

easyJet believes that the market power of BAA's London airports is one of the reasons for their poor service quality. However, easyJet has not been able to move aircraft out of BAA's airports, despite their low service quality, as there are no substitute airports in the South East with surplus capacity. Following the acquisition of GO Fly in 2002, easyJet did reationalise its use of aircraft based at Stansted, which allowed easyJet to reduce the number of aircraft based there.

5 December 2007

Supplementary memorandum from the Department for Transport (BAA 10A)

INTRODUCTION

1. The Department for Transport appeared before the Transport Select Committee on 28 November 2007 to provide evidence for the hearing on *The Future of BAA*. This note provides supplementary evidence related to the issue of airport capacity at Heathrow.

CONTEXT

2. In the hearing, the Transport Select Committee expressed an interest in the approach taken by Government to the development of capacity at Heathrow Airport in the 1990s and beyond. Government clearly recognises both the need for airport development and our environmental responsibilities. The Future of Air Transport White Paper in 2003 was the logical consequence of a long and considered process of strategic planning.

3. This note summarises the development of policy since the 1985 White Paper to the present day. It draws heavily on the reports of the Terminal 5 public inquiry, to which the Committee may wish to refer.⁶⁵

4. In particular it summarises the development of policy with reference to the following:

- 1985 *Airports Policy* White Paper;
- *Runway Capacity to Serve the South East (RUCATSE)* studies, commissioned in 1990 and the Government's response;
- Development of plans for Terminal 5 at Heathrow in the 1990s;
- 1998 *A New Deal for Transport White Paper: Better for Everyone*;
- SERAS studies; and
- 2003 *The Future of Air Transport* White Paper and 2006 Progress Report.

1985 AIRPORTS POLICY WHITE PAPER

5. The Department for Transport (and its predecessors) have published a series of White Papers over recent decades setting out its policies on aviation. In 1985, it published the Airports Policy White Paper. The key objectives for aviation were:⁶⁶

- to foster a strong and competitive British Airline industry by providing enough airport capacity where it is needed;
- minimise the impact of airports on the environment generally; and to ensure that land use planning and conservation policies take fully into account both the development needs arising from airports and the environmental consequences;
- to make the best use of existing facilities and provide new capacity only when this is economically justified;
- to encourage the use and development of regional airports so that they meet the maximum demand they can attract; and
- to support the leading position of Heathrow and Gatwick among the world's major international airports and interlining centres.

6. This White Paper set the framework for future airports policy, addressing in addition, the proposed privatisation of BAA.

RUCATSE STUDIES, COMMISSIONED IN 1990

Scope of the work

7. The 1985 White Paper included forecasts of air passenger demand and air traffic movements. However, it became clear that traffic in controlled airspace over South East England was continuing to grow. Government drew the conclusion that additional runway capacity may be required. The then Secretary of State had requested advice from the CAA, and a working group to consider Runway Capacity to Serve the South East (RUCATSE) was given its terms of reference on 26 November 1990.⁶⁷

⁶⁵ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5.

⁶⁶ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Paras 1.3.2 to 1.3.5.

⁶⁷ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Para 1.2.33-1.2.34.

8. The Government recognised that additional runway capacity had the potential for significant impacts on the environment and economy. Therefore, the Terms of Reference stipulated that no Greenfield site was to be assessed. Those airports identified for more detailed assessment were Heathrow, Gatwick, Stansted and Luton.

9. Promoters of a Thames Estuary scheme, “Marinair”, presented material to the group but it was not considered in the same detail as for the main sites. For the RUCATSE studies, assumptions were made as to the throughput achievable on the existing runways (the “Base Case” capacities). For Heathrow, the provision of a fifth terminal was assumed, but without prejudice to any planning application. A sensitivity test was carried out of the effects if the fifth terminal did not proceed.

Key findings of RUCATSE

10. The results of the work were published in July 1993. RUCATSE had concluded that only the four existing major South East airports (Heathrow, Gatwick, Stansted and Luton) offered worthwhile prospects, in terms of runway capacity, of responding to forecast levels of demand without serious inconvenience and cost to users. In the RUCATSE base case, the Heathrow runways were operating at capacity from 1995 to 2020.⁶⁸

11. The scope for increases in passenger numbers through more intensive use of runway slots was seen as limited and would occur mainly through increases in the number of passengers per aircraft. At Gatwick there would be runway capacity constraints from about 2005. Some further growth would arise from the use of larger aircraft but the constraint of 35 mppa would bite at 2015.

12. At Stansted, there would be spare runway capacity until around 2015, and Luton would be operating at capacity throughout the period, constrained by the rate at which the airport operators considered they could add capacity. Luton would reach its full capacity of 20 mppa between 2010 and 2015.

13. A sensitivity test was undertaken by RUCATSE to investigate the effects of the base case assumptions on the timing of an additional runway. Without an additional 25 mppa capacity at Heathrow, the test showed all the London airports operating at capacity at 2010. Stansted and Luton would reach their capacity five years earlier and there would be a faster build up in traffic at the regional airports.

Government response to the RUCATSE work

14. The Government’s response was announced on 2 February 1995 by Dr Brian Mawhinney, the then Secretary of State for Transport. Government recognised the need to make best use of existing runway facilities and promote the sustainable growth of airports. Further work was therefore commissioned on each of these issues.

15. On making best use of existing runway facilities in the South East, further work was initiated from the CAA to investigate the scope for increasing movements on Heathrow’s existing runways, and the associated environmental impacts. The Government’s response to RUCATSE also indicated that development of the less busy airports should be encouraged, for example by providing greater commercial opportunities through the liberalisation of transatlantic air routes and attention was drawn to the additional capacity available at Stansted. However, the pattern of demand might result in an airport being less than fully utilised.⁶⁹

16. On capacity, it was concluded that RUCATSE’s analysis showed a strong case for additional runway capacity in the South East, but that BAA should not consider further the particular options which were studied in RUCATSE for a third runway at Heathrow and a second runway at Gatwick.⁷⁰

17. Instead, BAA was invited to investigate the possibility of smaller scale options for development, such as a close parallel runway at Gatwick. With this invitation, the statement in para 5.22 of the 1985 White Paper that there should be no second runway at Gatwick had become subject to review. In addition, the fact that Stansted had been included as one of the options to be examined by RUCATSE in 1990 for a second runway represented a potential departure from the assurance given in para 5.36 of the 1985 White Paper that there would be no second runway at Stansted, although Government continued to regard the prospect of a second runway at Stansted as not being realistic for a very considerable time into the future given demand forecasts.

18. Gatwick had been chosen for additional investigations in spite of the recognition that further runway capacity would be required around 2010–15, and there was a 1979 agreement between BAA and the West Sussex County Council that BAA would not “construct or cause or permit to be constructed” a second runway at Gatwick before 2019.

⁶⁸ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Paras 3.4.20–3.4.21.

⁶⁹ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Para 1.2.26.

⁷⁰ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Paras 1.2.35–1.2.39.

19. Although BAA had been asked to consider different options in terms of close parallel runways at Gatwick, this did not rule out the investigation of other options, such as that put forward by the British Air Transport Association (BATA) for a close parallel runway at Heathrow. Furthermore, it remained open to any other body to put forward other options for runway development.

20. The scope for runway capacity enhancement at Heathrow was also being examined; and BAA had initiated a study on surface access links to airports. In accordance with the Government invitation, BAA had commissioned studies of a close parallel runway at Gatwick, but in a Parliamentary Question answered in July 1998 the Parliamentary Under Secretary of State indicated that BAA had been asked to put the work on hold while the Government considered how to take the matter forward in the light of the White Paper of 1998.

21. There had been no decision to change policy on any of the environmental mitigation measures set out in the 1985 White Paper. However, as a result of Dr Mawhinney's statement in February 1995, those matters in the 1985 White Paper which should be taken as being subject to review included continued Government support for runway alternation, and Noise Preferential Routes at Heathrow. Other environmental mitigation measures subject to review as part of the work were the Cranford Agreement and westerly preference.⁷¹

TERMINAL 5 DEVELOPMENT

22. The national policy towards airport development was laid out in the 1985 White Paper. The wish to meet air travel demand where and when it arises was the centre of Government policy.⁷² However, there had been a growing recognition of the importance of sustainable development so the environmental implications of any proposals for airport development were subject to a full assessment. If these were unacceptable it could mean that the demand for air travel would not be met.

23. National policy also supported the concentration of airport development at existing sites and making the best use of existing facilities. This did not imply that the maximum use should be made of the theoretical capacity of any airport but equally there was no national policy that development at Heathrow should be restricted until all the available capacity at other airports in the South East was used up.⁷³

24. A key constraint at Heathrow was the availability of terminal capacity. Consequently, applications for planning permission for a fifth terminal at Heathrow Airport were submitted in February 1993. The planning inspector's report of 7th December 2000 concluded "Terminal 5 should be permitted subject to strict conditions". These included "In particular the number of aircraft movements should be limited to 480,000 atm's a year and the area enclosed by the 57 dB(A) LAeq 16hour contour restricted to 145 km2. Operations at night should also be more strictly controlled and BAA should be required to ensure that both the Heathrow Express and the Piccadilly Line are extended to Terminal 5".⁷⁴

1998 TRANSPORT WHITE PAPER

25. The objectives for aviation as set out in the 1985 White paper were not changed in the 1998 White Paper called *A new deal for transport: better for everyone*. There were some areas of policy that had however developed. These included the broad policy that was set out for regional airports which encouraged their growth to meet local demand where consistent with sustainable development principles.⁷⁵

26. The 1998 White Paper also made reference to improving the utilisation of existing capacity where this might be desirable, and Government could consider regulatory measures to do so.

27. The 1998 White Paper stated that the Government intended to prepare a UK airports policy which would apply to UK airports the policies set out in the 1998 White Paper. It would look some 30 years ahead, and as the policy evolved, it would take account of the Inspector's report on the Terminal 5 Inquiries. A study of airport issues in the South East and East of England was announced by the Minister of Transport Dr John Reid in March 1999.⁷⁶

28. The study was not to look at the case for Terminal 5 at Heathrow or any other projects for which planning applications had been made or were imminent.

29. This White paper therefore paved the way for a further extensive programme of work on airport capacity and options, followed by consultation, which informed the 2003 Air Transport White Paper.

⁷¹ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Para 1.2.39.

⁷² *The Heathrow Terminal 5 and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment Transport and the Regions. Summary Report (para 16).

⁷³ *The Heathrow Terminal 5 and Associated Public Inquiries*: Report by Roy Vandermeer QC to the Secretary of State for the Environment Transport and the Regions. Summary Report (para 17). December 2000.

⁷⁴ *The Heathrow Terminal 5 and Associated Public Inquiries*: Report by Roy Vandermeer QC to the Secretary of State for the Environment Transport and the Regions. Summary Report. Para 100, December 2000.

⁷⁵ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Para 1.2.11.

⁷⁶ *The Heathrow Terminal Five and Associated Public Inquiries*. Report by Roy Vandermeer QC to the Secretary of State for the Environment, Transport and the Regions. Topic 1: the need for terminal 5. Para 1.2.7.

SERAS STUDIES

30. In the lead up to the 2003 the Future of Air Transport, the Government considered many hundreds of options for new airport capacity in the UK. After a detailed sifting process, options were narrowed down and published in seven regional consultation documents which comprised many options for new capacity at existing and new airports. The South East consultation presented 15 packages of new runway options at existing airports and included a proposal for a new four runway airport at Cliffe in North Kent.

31. During the consultation, the Government received proposals for a number of alternative new airports in the South East, such as estuarial airports. These were evaluated and the Government concluded that there was greater merit in pursuing development at existing airports in the South East. In the White Paper at paragraph 11.106, the Government reported on its analysis of the new site proposals and summarised the grounds why these proposals were not supported.

32. This body of work was therefore used to inform the policy conclusions set out in the 2003 Future of Air Transport White Paper.

2003 AIR TRANSPORT WHITE PAPER⁷⁷

33. To meet the 1998 White paper commitment, this White Paper set out a strategic framework for the development of airport capacity in the United Kingdom over the next 30 years, against the background of wider developments in air transport and the environment.

34. It did not itself authorise or preclude any particular development, but set out a policy framework against which the relevant public bodies, airport operators and airlines could plan ahead, and which would guide decisions on future planning applications. It set out the conclusions of the Government, and of the devolved administrations where appropriate, on the case for future expansion at airports across the country. In doing so it took account of views expressed in an extensive consultation exercise, in the course of which around 500,000 responses were received.

35. In relation to additional capacity in the South East of England, the 2003 White Paper set out the following policy conclusions:

- There was an urgent need for additional runway capacity in the South East.
- There was no strong case for the development of a second international hub airport alongside Heathrow.
- The first priority was to make best use of the existing runways, including the remaining capacity at Stansted and Luton.
- Provision should be made for two new runways in the South East by 2030, although demand forecasts showed an even greater need, as this provided the best balance between promoting economic growth and protecting the environment.
- The first new runway should be at Stansted, to be delivered as soon as possible (around 2011 or 2012).
- The further development of Heathrow was supported, including a further new runway and additional terminal capacity to be delivered as soon as possible (within the 2015–20 period) after the new runway at Stansted, but only if stringent air quality and noise limits could be met. An urgent programme of work and consultation would be started to examine this issue further and to consider how best use could be made of the existing airport.
- The Government would not seek to overturn the 1979 planning agreement preventing construction of a second runway at Gatwick before 2019.
- In case the conditions attached to the construction of a third Heathrow runway could not be met, and since there was a strong case on its own merits for a new wide-spaced runway at Gatwick after 2019, land should be safeguarded for this.
- The option to develop two or three additional runways at Stansted was not supported.
- The option for two new runways at Gatwick was not supported.
- The development of a second runway at Luton was not supported but we agreed to a lengthening of the runway.
- The option to develop a new airport at Cliffe was not supported.
- The development of Alconbury for passenger or freight services was not supported, but the potential for relocation there of aircraft maintenance operations from Cambridge was recognised.
- There was scope for other existing South East airports, including London City, Norwich, Southampton and some smaller airports, to help meet local demand, and their further development was supported in principle, subject to relevant environmental considerations.

⁷⁷ *The Future of Air Transport*, December 2003. Department for Transport.

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- No other proposals put forward during the consultation for new airports at alternative locations were supported.

36. It is important to recognise however that unlike transport infrastructure such as the strategic road network for example, in the UK, our airport infrastructure is, in most cases, provided and funded wholly by the private sector. At airports therefore, decisions on the provision, enhancement and expansion of airport capacity are based entirely on commercial considerations and are not within the remit of Government.

37. BAA changed ownership in 2006. At acquisition, BAA's new owners, Airports Development and Investment Limited (ADI—the consortium including Ferrovial that was formed to acquire BAA) stated their commitment to delivering the airport capacity needed in the South East as set out in the *Future of Air Transport* White Paper.

38. A Progress Report was published in December 2006⁷⁸ setting out the progress made against these White Paper policies and included updated forecasts of air travel demand and aviation carbon dioxide emissions. More recently, the Heathrow consultation *Adding Capacity at Heathrow Airport* was published in November 2007⁷⁹ alongside updates to air travel demand and aviation carbon dioxide emissions.⁸⁰

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⁷⁸ <http://www.dft.gov.uk/about/strategy/whitepapers/air/aviationprogressreportsection>

⁷⁹ <http://www.dft.gov.uk/consultations/open/heathrowconsultation/>

⁸⁰ <http://www.dft.gov.uk/pgr/aviation/environmentalissues/ukairdemandandco2forecasts>