

# Office of Fair Trading: Market Study of UK Airports

## A Submission from British Air Transport Association (BATA)

BATA welcomes the opportunity to make a submission to the OFT respond in regard to its market study of UK airports. BATA represents UK-registered airlines, in the scheduled, charter and cargo sectors. Its members produce more than 80% of UK airline output and operate at most major UK airports including all the BAA airports and Manchester.

BATA members represent about 40% of passengers at BAA's London airports, about 55% at BAA's Scottish airports and about 50% of Manchester's passengers<sup>1</sup>.

We agree with the OFT's reasons for conducting the study<sup>2</sup>, the most important of which are the very high local market shares enjoyed by BAA in SE England and Scotland and by Manchester in the North of England.

### Summary

- The OFT should take care to distinguish between airlines and passengers when considering the airport market and the interests of users of airports.
- The regulatory regime has had a benign effect on airports, shielding them from some risks.
- The BAA dominance in SE England has led to the cross-subsidisation of Stansted airport and the BAA has exerted undue influence on the Government's SE England airports strategy.
- Regardless of ownership, there will be a continuing need for regulation at capacity constrained airports.
- Intra-airport competition may be viable in certain circumstances although there are practical issues that would need to be resolved. Airports should not be allowed to extend their monopoly unchallenged into other areas such as the provision of IT, CCTV cameras and self-service kiosks.
- There are compelling reasons for a market investigation reference to the Competition Commission regarding BAA airports.

### The Regulatory Regime

Certain airports in the UK operate under economic regulation by the CAA. This was introduced by the Airports Act 1986 when the BAA was privatised. Under section 39 of the Act, the CAA has to consider four objectives when discharging its duty:

1. to further the reasonable interests of users of airports within the United Kingdom;

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<sup>1</sup> Estimated from CAA Airport Statistics 2005, Table 8.

<sup>2</sup> UK Airports. 30<sup>th</sup> June 2006

2. to promote the efficient, economic and profitable operation of such airports;
3. to encourage the investment in new facilities at airports in time to satisfy anticipated demands by users of such airports; and
4. to impose the minimum restrictions that are consistent with the performance by the CAA of its functions under those sections.

There are important differences between airlines and passengers as regards their abilities to take advantage of competition amongst airports. Passengers may pick and choose without incurring significant transfer costs. Airlines, especially UK airlines at a base or hub airport, cannot change easily. A UK airline at its base or hub will have acquired facilities on long leases and locally based staff. Moving will incur significant costs and disruption. The OFT should take care to distinguish between airlines and passengers when considering the airport market and ‘the reasonable interests of users of airports’.

The regulatory regime is designed to act as a surrogate for competition but it is an imperfect alternative. The price cap mechanism has the effect of shielding designated airports from many risks. For example, the normal response by airlines to downturns in demand is to reduce fares to maintain passenger volumes. Not only does this help reduce the airport’s volume risk but also, since the price cap is in terms of an average yield per passenger, there is no revenue yield risk for the airport.

Furthermore, the price cap includes a return on capital expenditure which shields the airport from investment risk since they are guaranteed a return on the regulated asset base in perpetuity. This, together with lack of competition, tends to lead airports into building infrastructure to their own specification ignoring the wishes of the airlines.

The benign regulatory regime can be seen in the relative financial performance of airlines and airports. Over recent years, not only has the rate of return for airlines been far less than that for airports, but airlines profits – if any - have been far more volatile reflecting the varying and often difficult trading conditions.

The last quinquennial review of the BAA designated airports (Heathrow, Gatwick and Stansted) produced an unsatisfactory result for airlines and a generous regime for BAA. This is evidenced by BAA’s continuing substantial profits, its capacity to secure debt for their £1.3bn investment in Budapest airport and the recent take-over by Ferrovial at a substantial premium to the previously prevailing share price. During the take-over battle, BAA was able to offer their shareholders about £750million as an inducement not to sell their shares.

### **The Impact of BAA Ownership in SE England**

Until recently, BAA cross-subsidised Stansted airport from Heathrow and Gatwick in an attempt to encourage airlines to move there. The result has been a rapid expansion of “no frills” services but, in effect, the airlines at Heathrow and Gatwick have been subsidising their competitors at Stansted.

The Government's policy as set out in the 2003 Aviation White Paper has left all the opportunities for new runways in SE England in the hands of BAA. This allows BAA to suppress growth at one airport to their advantage elsewhere. We believe that BAA has exerted undue influence on the Government's SE England airports strategy. The BAA has lent only weak support to expanding Heathrow as the UK's national hub airport. This led to the Aviation White Paper giving preference to a second runway at Stansted when almost all airlines, both UK and foreign, wanted a third Heathrow runway as soon as possible. This suggests a separation of Stansted and Heathrow.

### **The Continuing Need for Regulation**

The market dominance of BAA in London and Scotland could be remedied to some extent by divestment. However care must be taken not to break up a large monopoly only to create several smaller ones. At Heathrow and Gatwick demand exceeds capacity and they are therefore natural monopolies in their own right regardless of ownership. These airports, and others if they become full, will have to remain regulated.

There is scope to improve the effectiveness of the regulatory regime especially in the area of service quality. BAA seems willing to let service standards slip in the interests of increasing passenger throughput. The BAA attitude to service quality and lack of contingency planning at Heathrow was evident when increased security measures were imposed following the events of 10<sup>th</sup> August 2006.

### **Competition between Airports**

The airline industry is intensely competitive and airlines are under constant pressure to reduce costs and improve efficiency. It is vital airports are under similar pressure to be cost efficient.

It would appear that the Government's attitude as regards BAA's dominance of the London market has been to leave well alone. No doubt it is convenient for the Government to deal with a single owner of the three biggest airports serving London, but we believe a different perspective should be taken. In our view, if the three airports had been separately owned from privatisation, it is highly unlikely that anyone would suggest that combining them was in the best interests of the travelling public or the airlines using the airports.

Separate ownership does not mean that economic regulation can be dispensed with. As noted earlier, airports that are at, or near to, capacity such as Heathrow and Gatwick are monopolies in their own right and will still have to be regulated.

The situation in Scotland is less extreme than London. Nonetheless, the two biggest airports, Glasgow and Edinburgh, are both owned by BAA. However the two airports are close enough to be able to compete with each other and we contend that, unless it can be demonstrated that there are compelling reasons for common ownership, the presumption should be that they should be separately owned.

In the North of England, although Manchester has a large market share and faces competition from several independently-owned airports, it is still the dominant airport in the region. As such the OFT should certainly review the market and judge whether a referral to the Competition Commission is justified for Manchester. We would definitely have concerns if the Manchester Airport Group acquired any more airports in the region and the OFT should consider whether existing competition law provides adequate safeguards.

### **Competition within Airports**

The OFT has suggested that competition within airports may be a potential remedy for competition concerns.

There are cases where this option might be practical, such as the provision of terminal capacity. There could be opportunities for development of new terminals by third parties to meet the requirements of an airline or group of airlines. There may be practical issues to be resolved associated with the provision of, and charging for, shared facilities though these would be a matter of negotiation between the provider and user. We recommend that OFT looks at existing examples, such as JFK's Terminal 4.

Competition between two or more runways would present complex challenges and, as far as we know, no such examples exist. We would be interested to see OFT's thoughts on this issue.

Care will have to be taken not to allow airports to extend their monopoly unchallenged into other areas such as the provision of IT, CCTV cameras and self-service kiosks.

### **Market Investigation Reference**

We strongly support a market investigation reference to the Competition Commission and we believe that the points that we have made provide a compelling case for such action.

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