



Putting Passengers First

Competition Commission

Market Investigation

BAA Limited - Initial Submission

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Executive Summary

BAA agrees that in the South East capacity constraints and development restrictions, and the regulatory framework are issues that adversely affect competition.

In the area of regulation, steps are already being taken that could lead to the de-designation of Stansted, and the Commission should consider the opportunities to develop a new approach to regulation at Heathrow and Gatwick.

With regard to capacity constraints and planning restrictions, the 2003 Air Transport White Paper creates a firm policy framework for the delivery of new capacity, and changes to the planning process offer the prospect of faster and more streamlined delivery of new runway capacity. The successful implementation of the recommendations from the Barker Review of Land Use Planning and the Eddington Transport Study, through the Planning White Paper, will also help deliver airport capacity more quickly than in the past.

However, the key issue for the Commission will be to establish whether a change to the ownership structure in the South East or in Scotland would, in fact, lead to competition between the airports.

In the South East, it is not clear how alternative ownership arrangements could deliver capacity more quickly or more cost-effectively than BAA. Separate ownership would, however, significantly increase the risks associated with delivering new runways, and thereby increase the likelihood of prolonged delay or outright failure – both outcomes that would have significant negative consequences for passengers, airlines and the UK economy.

In Scotland, Edinburgh and Glasgow airports serve separate local markets where passengers do not view the airports effective substitutes. As a consequence, competition between Edinburgh and Glasgow is highly unlikely and a change in ownership would not alter this.

Common ownership has yielded significant benefits for consumers in the South East and Scotland and remains the best structure for the efficient operation of airports, and the timely and cost effective delivery of new airport capacity – the most important issue for passengers.

1. Introduction

- 1.1. The aviation industry is of great importance to UK consumers and the wider economy, and BAA is proud of the contribution it has made to its success, especially over the twenty years since privatisation. In this period, the company has invested in major new facilities, found solutions to difficult planning issues and secured permissions for new capacity, enabled the growth of 'low frills' airlines, driven innovation across all areas of its business and dealt effectively with a series of external shocks.
- 1.2. BAA would ask the Commission to take time to consider these achievements carefully in the context of this investigation. The achievements are a strong and positive indication of the company's ability to address the key challenge of improving passengers' experience of travelling through our airports.
- 1.3. Looking ahead, it is clear that aviation will become ever more important, as identified by the Government, with good air transport links being critical to the UK's overall prospects in a global economy. At a passenger level, the availability of reasonably priced air travel to and from the UK will be an important factor in enabling as many people as possible to travel and experience other cultures.
- 1.4. BAA was purchased by ADI in 2006, a consortium led by Ferrovial. Under new ownership and new leadership we have established higher ambitions for running airports well for passengers and airlines. BAA is committed to transforming the passenger experience. The first major step in this process will be the delivery on 27 March 2008 of significant new terminal capacity at Heathrow in the form of Terminal 5, one of Europe's largest construction project, on time and on budget.
- 1.5. Even though BAA has been successful over the last twenty years in securing a series of planning permissions to deliver major new capacity additions, the London airports are at full terminal capacity and, in the case of Heathrow, full runway capacity. This significantly constrains our ability to deliver on the needs of passengers and airlines. Operating at capacity, relatively minor events can cause major disruption at airports, and without new capacity, congestion will increase at all principal bottlenecks: check-in, lounges, gates, aircraft stands. This risk to the passenger experience is compounded by the escalating climate for risk in the aviation sector in general, and for our airports in particular.

- 1.6. BAA's proposals for Heathrow, submitted to the Competition Commission for the purposes of the price control review, set out the case for transforming the experience for users through the development of terminal capacity and facilities. With a satisfactory regulatory settlement, BAA can complete Terminal 5 and move into the next phase of Heathrow's transformation – the Heathrow East project, and progress ambitious plans to refurbish Terminals 3 and 4.
- 1.7. At Gatwick, BAA's proposals include the renovation of both the South and the North terminals, and we are continuing to talk to airlines about their aspirations for investment in these facilities to be brought forward.
- 1.8. At Stansted, BAA is progressing with further development of passenger facilities to make the most of the existing runway, and also advancing our plans to open a new runway and associated facilities by 2015 – the first new runway in the South East in over 60 years.
- 1.9. In Scotland, BAA is continuing to support airline development with investment in new infrastructure and facilities, while at the same time reducing the level of airport charges in real terms and delivering higher standards of passenger experience.
- 1.10. These plans put the passenger first and have been developed with complete support and endorsement from new ownership and leadership to overturn capacity constraints and transform the passenger experience. BAA's new investors take a long term view of achieving the returns on their investment and are putting in place the financing arrangements to underpin their ambitions to invest for the long term.
- 1.11. In this context, the Commission's current market investigation will be a critical milestone in the development of the UK aviation industry, and BAA looks forward to participating fully in this debate. This submission provides BAA's initial views on the structural features in the South East and Scotland that the Office of Fair Trading identified in its reference to the Commission.
- 1.12. Section 2 provides BAA's views on the likely scope of the market investigation. Sections 3 and 4 discuss the South East market and whether joint ownership affects the scope for competition. Section 5 discusses the Scottish market and the scope for competition between the airports in the Lowlands. The remaining sections then comment on the other features identified by the OFT as having potentially adverse effects on competition.

2. Scope of the market investigation

- 2.1. In its reference to the Commission, the OFT identified three inter-linked features: BAA's joint ownership (with high shares of regional air travel); regulation; and development restrictions and capacity constraints. The OFT found what it considered to be reasonable grounds to suspect that these features prevent, restrict or distort competition with adverse consequences for customers and consumers using BAA's airports in the UK.
- 2.2. In order to make a market investigation reference, the OFT needed to identify reasonable grounds for suspecting that any feature or combination of features of a market have an adverse effect on competition. The OFT acknowledged that this is a relatively low threshold that did not require it to carry out an in-depth investigation or establish conclusively that these are features that have adverse effects.
- 2.3. It should be noted that with respect to common ownership BAA disagrees with significant elements of the OFT's analysis and would wish to challenge the conclusions reached in this area. In particular, BAA is concerned by the weight the OFT attached to unsubstantiated views and statements submitted by airlines.
- 2.4. The Enterprise Act 2002 requires the Commission to go further than the OFT. The Commission needs to determine whether there is any feature of the market which prevents, restricts or distorts competition, and then decide whether it should take action or recommend action by others to remedy, mitigate or prevent any adverse effect on competition or detrimental effects on passengers.
- 2.5. The scope of the Commission's investigation will necessarily be broad, raising as it does a wide range of complex issues – such as market definition, ownership structure, capacity constraints, the UK planning system, investment, economic regulation, slot allocation, airline competition – and, critically, the inter-relationships between all these issues.
- 2.6. In particular, we suggest that the Commission will need to develop a clear and insightful understanding of how the markets for airport services in the South East and Scotland operate. This submission returns to this issue in Section 3 in connection with the South East market, and in Section 5 in connection with the market in Scotland.

- 2.7. The OFT reference leaves open a number of issues for further consideration by the Commission, in particular BAA's ownership of Southampton and Aberdeen. BAA does not understand the reasons for the OFT's approach, and would encourage the Commission to determine at an early stage the relevance of these issues in the context of the reference, and to consider excluding them at the earliest appropriate opportunity.
- 2.8. The key issue for the Commission, we suggest, will be to determine whether a change of ownership of one or more airports in the South East or in Scotland would, in fact, lead to competition between the airports and provide benefits to consumers. To come to a robust decision on this issue it will be necessary, we suggest, for the Commission to demonstrate how it assesses and weighs up the benefits, costs and risks associated with imposing structural remedies.
- 2.9. Forcing break-up on a successful business would be a radical step with few precedents. BAA was privatised as a single entity in circumstances where there was arguably far greater scope for competition than exists today. In our view, this was because it was thought that joint ownership would provide a stable basis for expansion of airport capacity. We would argue that this rationale still holds true. Against this background, BAA submits that any decision to break up the company needs to be based on sound evidence that there are clear, demonstrable and significant benefits to be gained from break-up and correspondingly few costs and risks entailed. BAA believes that the OFT's preliminary analysis falls well short of this hurdle.

3. The South East Market

Summary

Airports in the South East have overlapping catchments, and many passengers will view different airports as potential substitutes. However, BAA's high share of passengers in the South East market is not a reliable guide to the potential for competition between BAA's airports. Heathrow's demand significantly exceeds available capacity, leading to unmet demand spilling over to other London airports. At these airports, passenger demand is a combination of 'natural demand' and 'spill', and the rate of traffic growth is determined to a large extent by the amount of spill from Heathrow.

The existence of capacity constraints, and binding price cap regulation at Heathrow and Gatwick means there is no material scope for competition between BAA's airports, at least until these constraints are alleviated. BAA does not consider that its ownership of Southampton airport needs scrutiny by the Commission.

- 3.1. BAA has consistently argued that the definition of the appropriate market needs careful empirical analysis. To be informative, such analysis needs to recognise the differences in passenger and airline characteristics, and the existence of constraints or other distortions that affect the operation of the market. In particular, analysis of passengers' and airlines' perspectives on the potential substitutability of different airports, though important, will not yield reliable insights into the scope for competition between airports in the presence of binding capacity and regulatory constraints.
- 3.2. BAA has developed a detailed understanding of passenger demand in the South East, the constraints that exist, and the ways in which passengers make choices between different airports. This understanding is reflected in the approach BAA uses to forecast passenger demand and throughput at its London airports – an approach repeatedly endorsed by successive planning and regulatory enquiries.
- 3.3. The approach recognises the existence of substantially overlapping catchments for the London airports by forecasting demand for air travel at an overall system level. The pool of demand is then distributed around the system according to our understanding of passenger and airline preferences for the different airports, taking account of the constraints and distortions that exist.
- 3.4. Amongst the London airports, Heathrow is the most desirable location for the largest number of passengers and airlines. This 'natural' preference for Heathrow is reinforced by the network or

'hubbing' benefits that airlines can exploit by co-locating a mix of long-haul and short-haul services, which creates additional demands for access to the airport.

- 3.5. Airlines are particularly attracted to Heathrow because of BAA's charges which are constrained by regulation to levels substantially below market clearing levels. Slot allocation rules, based largely on grandfather rights to use equivalent runway slots in the next season, further distort the usage of Heathrow capacity towards airlines that have historically served the airport, rather than reflecting an efficient market allocation of capacity. Administrative distortions also exist in the form of restrictions on the airlines and market segments that can gain access to Heathrow, and to some extent Gatwick.
- 3.6. The existence of capacity constraints at Heathrow, and the airport's inability to add new capacity in the immediate future, means that the airport is unable to accommodate passenger and airline demands for access. Demand that cannot be met at Heathrow 'spills' away from the airport, and is either picked up by airlines serving other London airports, or is lost from the system altogether. For those passengers that do use Heathrow, air fares tend to increase to reflect the scarcity value of limited airport capacity. The value of slot trades at Heathrow supports this analysis.
- 3.7. The types of passengers that are most likely to spill from Heathrow are generally transfer and short-haul passengers. This pattern of displacement has been experienced at Heathrow in recent years, with falling transfer volumes substituting to other European hubs and the withdrawal of short-haul routes to accommodate additional long-haul services. One consequence of this has been a fall in number of destinations served from Heathrow.
- 3.8. Capacity constraints are not limited to Heathrow. Gatwick is now full most of the time, and Stansted at peak times. Further demand for access at those airports will lead to a similar 'spill' process around the London system including to non-BAA airports. This iterative process will continue over time until each airport reaches capacity, at which point further growth in demand will be lost from the system altogether.
- 3.9. The process will be influenced, to some degree, by airline and airport competition from outside London, with a clear example being the competition between European hubs for transfer passengers. BAA's London airports will also face competition from other airports as a result of the decisions that airlines make about route networks and service frequencies.

- 3.10. The existence of overlapping catchments is consistent with the evidence BAA submitted to the OFT concerning the origins and destinations of the passengers travelling through the London airports. BAA anticipates that, in time, the Commission's own analysis will also reveal the overlapping nature of the catchments for the London airports. The CAA's analysis also supports this view.
- 3.11. However, the OFT used the existence of significant overlaps in catchment areas to conclude that there is a clear potential for London airports to compete. For the reasons set out here, BAA does not agree with this conclusion and looks forward to discussing with the Commission a more robust definition of the market and the nature of the constraints that affect the ability of airports to compete.
- 3.12. We accept that in the absence of constraints, a structural solution might be theoretically capable of generating competition between airports. However, we submit that the existence of capacity constraints, price caps, and other distortions and differentiating factors means that competition will not, in practice, materialise to any meaningful extent, and therefore will not deliver benefits to passengers.
- 3.13. Put simply, without spare capacity and in the presence of charges that do not reflect an economic level of prices, competition could not develop and separate ownership would be unlikely to make any difference to market outcomes.

4. Ownership of airports in the South East

Summary

BAA's ownership of airports in the South East has yielded significant benefits for consumers since privatisation and is not a feature that adversely affects competition. Until new runways are delivered the existing capacity constraints, combined with the regulatory price caps, effectively prevent competition between Heathrow, Gatwick and Stansted. New capacity is expected to be available between 2015 and 2020, after which the potential for competition to develop between airports could increase.

It is unclear how separate ownership could deliver additional runway capacity more quickly or more cost-effectively than BAA. Separate ownership would, however, significantly increase the risks associated with delivering a new runway, and thereby increase the likelihood of prolonged delay or outright failure. In effect, separate ownership would at best act as a brake on the prospect of competition by threatening to delay new capacity, and at worst annul the prospect of competition altogether.

Common ownership therefore remains the best structure for the efficient operation of airports, and the timely and cost effective delivery of new airport capacity – the most important issue for consumers in terms of air fares, choice of destinations and service quality.

- 4.1. The OFT concluded that the existence of overlapping catchments for airports in the South East suggested, in theory at least, that there is short-term potential for the airports to compete. The reality though, is that the preferences of passengers and airlines are heavily constrained by the lack of spare capacity, and distorted by a variety of other factors including slot allocation rules, price regulation and airline economics.
- 4.2. The fact that Heathrow's runways are full throughout the day, and Gatwick only has small amounts of spare capacity at off-peak times (all of which has been confirmed by the OFT), means that there is currently no real scope for competition between BAA airports in the South East, especially taking into account the effect of regulatory price caps. This will remain the case at least until new runway capacity is delivered at Stansted in 2015, and potentially at Heathrow from around 2020.
- 4.3. Although London's airports will be put under increasing pressure to handle additional passengers in this period, BAA's priority is to deliver a higher level of service to passengers and airlines.

Under the new management, the airports are working hard to raise the level of passenger experience by transforming and replacing tired and outdated facilities. It is unclear how these improvements in customer service could be delivered more quickly or more effectively by airports under separate ownership.

- 4.4. In the long run, the availability of new runway capacity will be the most important influence on passengers' interests. BAA's and the Government's traffic forecasts show that there will be passenger demand for at least two new runways in the South East over the next twenty years. A failure to provide these new runways will have significant consequences for the UK in terms of the range of destinations available, the cost of air travel, and the quality of service delivered to passengers.
- 4.5. BAA has an excellent track record of solving difficult planning problems and obtaining permissions for new capacity, overcoming determined opposition from local and national stakeholders. Terminal 5 is the highest-profile example of where BAA's expertise and experience of the planning system has enabled the development of new capacity. Significant planning permissions have also been secured for new capacity at Gatwick and Stansted.
- 4.6. The 2003 Air Transport White Paper identifies clearly the location and likely timing of new runway capacity in the South East, having weighed up a range of factors including local, regional and national interests, environmental issues and economic growth. Within this framework, BAA is pressing ahead with the development of proposals for a runway at Stansted. BAA has also taken a leading role in the technical work required at Heathrow to assess the levels of performance that will be required to meet the environmental limits that have been established by the Government as conditions of further development there, and subject to the outcome of the Government's forthcoming consultation BAA will take forward proposals for additional runway capacity at Heathrow.
- 4.7. From the preliminary work at Heathrow, we already know that meeting these limits will not be easy and will almost certainly require significant improvements in the environmental performance of aircraft using the airport. Meeting the targets will also require a concerted effort with a range of other stakeholders to improve road-based environmental impacts around the airport, for example on the M25 and the M4. We would urge the Commission to develop a detailed understanding of the constraints that apply to further development at Heathrow, and the likely timing of new capacity.

- 4.8. All of this work at Stansted and Heathrow, draws on the company's wide base of skills and experience of securing permissions for previous development projects, and our intimate knowledge of the UK's planning process.
- 4.9. In the light of this, BAA straightforwardly rejects the OFT's proposition that consumers would benefit from airports in separate ownership competing to develop new capacity. BAA believes that the implementation of Government policy as contained in the White Paper, and currently being delivered by BAA, is the best means of securing permission for new runway capacity.
- 4.10. The promotion of planning applications for major infrastructure projects is a highly complex and technically demanding process. It is quite unclear, given this context, how a separately owned airport could accelerate the planning process to deliver a runway more quickly than another airport. The Government's experience in developing the White Paper, where it faced several judicial reviews, shows that failures of process will be legally challenged by those seeking to frustrate the development of new runways.
- 4.11. Encouraging separate owners to work against each other in the delivery of new capacity would introduce significant new risks into the planning process, with the potential for substantial delay or outright failure, which could result in no permissions for new runways being secured. Furthermore, promoting a runway development that was not consistent with Government policy, as set out in the White Paper, would incur significant costs and face considerable risks given the substantially higher likelihood of failure.
- 4.12. These risks and uncertainties need to be viewed against BAA's excellent record since privatisation, and the considerable progress that BAA is making on transforming and developing its airports for the future.
- 4.13. With new capacity, airports will have the opportunity to enhance the passenger experience by reducing the pressure on existing infrastructure and redeveloping tired and out-dated facilities. The new capacity would also benefit passengers by encouraging greater competition between airlines, both in terms of the prices and services they offer, and enabling airports to support a more diverse range of destinations and higher service frequency. The 'low frills' revolution needed the capacity provided by BAA to deliver the undoubted benefits to passengers that have resulted at all of London's airports.

- 4.14. BAA, under the current ownership structure, is clear about how development in the London system should be taken forward. BAA is confident that its skills and experience can secure the necessary planning permissions in the shortest possible time, and that new capacity will be delivered as quickly and cost-effectively as possible. None of these statements can be said to apply with any certainty to the alternative ownership arrangements that might be considered.
- 4.15. The current structure also ensures that users benefit from the cost synergies and efficiencies that result from joint ownership. Break-up would result in higher costs at each of the airports which would ultimately be to the detriment of passengers.
- 4.16. For these reasons BAA does not accept that common ownership of BAA's airports in the South East is a feature of the market that adversely affects competition. BAA is confident that in the course of the investigation it will demonstrate that the current ownership arrangements provide the most effective and efficient means of securing new capacity and therefore continue to be in the best interests of passengers.

5. Ownership of airports in Scotland

Summary

BAA's ownership of Edinburgh and Glasgow airports has benefited consumers since privatisation, and does not constitute a feature that adversely affects competition. BAA does not consider that its ownership of Aberdeen airport needs scrutiny by the Commission.

Strong empirical evidence shows that unlike the South East, Edinburgh and Glasgow have essentially separate 'local markets' for air travel, making meaningful competition between them very unlikely. The need for a new runway in Scotland is distant enough that the scope for competition to build capacity should not be a material issue in this investigation.

BAA is therefore confident that it will demonstrate that the current ownership arrangements continue to be in the best interests of consumers and in the best interests of Scotland.

- 5.1. Since BAA was privatised in 1987, the number of passengers using Edinburgh, Glasgow and Aberdeen has grown from less than 7 million travellers a year to more than 20 million today. This rise in passenger traffic equates to an annual growth rate of over 6%, and has been underpinned by the sustained growth of the Scottish economy, particularly the financial services sector.
- 5.2. The airports have operated in passengers' interests by achieving high levels of operating efficiency, good customer service, innovation and reducing levels of airports charges. In this regard, BAA's Scottish airports are good examples of airports working well for passengers, without recourse to the type of formal price regulation applied in the South East.
- 5.3. BAA's Lowlands airports have consistently reduced prices over the last 14 years, as a result of a voluntary commitment to reduce tariff prices by at least RPI-3%. Further, both airports have adopted market pricing strategies to encourage growth of airline routes at the airports. These pricing strategies have been developed to address the specific market conditions at each airport and the specific interests and requirements of the individual airline customers. This has been a highly successful strategy for delivering growth and is a strategy that has direct, immediate and tangible benefits for passengers. These benefits are achieved through natural market responses without imposing regulation and its constraints on investment and the pace of service and capacity delivery.

- 5.4. This voluntary price reduction strategy has also been paralleled by significant infrastructure investment to support the resultant growth in air travel. Over £600m has been spent in Scotland since privatisation and plans are in place for further significant capital spend to support the delivery of the Government's White Paper. The stable ownership structure has allowed BAA to invest these substantial sums with confidence and in conjunction with our stakeholder partners who have direct and pressing planning and economic development interests that are supported by airport development.
- 5.5. BAA's core strategy of engaging with its external stakeholders in Scotland is manifest and extensive. Through the development of its 25-year masterplans for all three Scottish airports, BAA consulted with hundreds of stakeholders and openly recorded their stated concerns and interests, reflecting these in the resultant plans and proposals. This engagement is acknowledged to have been full and meaningful and has resulted in widespread support for the masterplans across all political and geographical interests in Scotland. BAA intends to maintain this strategy of working with its stakeholders to deliver maximum economic and social benefit through successful and sustainable development, built on consensus.
- 5.6. The evidence on passengers' origins and destinations demonstrates clearly that Edinburgh and Glasgow serve separate markets: passengers in the West gravitate towards Glasgow and Prestwick, and passengers in the East gravitate towards Edinburgh. Passengers' natural affinity for local airports in the Lowlands is reinforced by the poor state of road and rail links between Edinburgh and Glasgow, which results in significant uncertainty for passengers around travel times between the two cities.
- 5.7. BAA submitted evidence to the OFT which identified the origins of passengers using Edinburgh and Glasgow airports. The data shows that there is a relatively small overlap in the catchments of the two airports, amounting to a small percentage of the combined passenger throughput. A much more significant overlap can be identified between the catchments for Glasgow and Prestwick airports.
- 5.8. This clear understanding of the markets in the Lowlands has been central to the way BAA has forecast demand for Edinburgh and Glasgow for many years. It is also apparent from the significant overlap of destinations served by both Edinburgh and Glasgow. For example in 2006, over 95% of Edinburgh's passengers travelled to destinations that were also being served from Glasgow. Airlines, including those operating transatlantic services, would be unlikely to serve

both destinations if there was a significant overlap in the catchments of the two airports. The existence of separate 'local markets' makes the prospect of meaningful competition between Edinburgh and Glasgow airports very unlikely.

- 5.9. In addition, BAA considers that the timing of any new runway in Scotland is distant enough that the prospect of competition between separately owned airports to deliver the new runway should not be a material consideration in the context of the Commission's investigation.
- 5.10. BAA believes that its voluntary price reduction commitments across both airport markets represent a good case for continuity of ownership. It would be highly uncertain whether airports under separate ownership would be willing to maintain such a long-term commitment.
- 5.11. Furthermore, BAA's track record on investment in Scottish airports is strong, and BAA's future plans for investment maintain this strategy that is in the clear interests of the passenger, both today and in the future. BAA's demonstrable commitment to stakeholders' interests and objectives provides a stable platform from which to grow airports and air travel for the benefit of all. A change of ownership structure could delay or reduce investment at Edinburgh and Glasgow.
- 5.12. For these reasons, BAA does not accept that common ownership of airports in Scotland is a market feature that adversely affects competition. As with the South East, BAA believes that the Commission will find that the current ownership arrangements continue to be in the best interests of passengers.

6. Development Restrictions and Capacity Constraints

Summary

New capacity is important for passengers, airlines and the economy. Following the approach established by other European governments, the UK Government set out in 2003 a clear policy for the development of airport capacity in the period to 2030 with the publication of the Air Transport White Paper.

This policy framework will be an important factor in delivering new capacity more quickly than before, but the planning system in the UK still operates considerably more slowly than in other countries. The recently published Planning White Paper recognises this weakness, and provides a critical opportunity to improve the planning process by simplifying and streamlining the requirements for major infrastructure projects. BAA would welcome the Commission's contribution to this important debate.

- 6.1. BAA agrees with the OFT that new capacity is a critical issue in the South East.
- 6.2. The annual throughput of London's airports has grown by around 80 million passengers over the last two decades. This is almost twice the level of growth achieved by other world cities over the same period. Despite this growth, a new runway has not been delivered in the London region in the last sixty years.
- 6.3. The pressing need for new capacity can already be seen by passengers passing through the London airports. A failure to provide new capacity will have wide ranging effects on passengers, airlines and the economy, with capacity constraints progressively driving up the costs of travel and limiting the range of destinations available from London's airports.
- 6.4. BAA's experience of securing planning permission for Terminal 5 demonstrates the challenges that have faced airports in developing new capacity in the past. The cause of much of the delay in the Terminal 5 Inquiry related to the lack of a strategic framework for development. BAA's record of success in securing planning permissions contrasts with failed applications in other sectors, for example ports and electricity infrastructure.
- 6.5. Despite BAA's success in delivering new passenger capacity over the last twenty years, the record of delivering new runway capacity in the South East contrasts sharply with the proven ability of London's European competitors – including Paris, Frankfurt and Amsterdam – to develop runways ahead of demand. The Governments in these countries recognised the importance of

providing political leadership to the process of delivering new runway capacity. This enabled capacity to be delivered relatively quickly, and passengers, airlines and businesses are now reaping the benefits of this approach.

- 6.6. In 1998, the newly elected Government identified the importance of establishing a clear policy framework for the development of new airport capacity in the UK. The Government committed to preparing a new air transport policy, and made it clear that it was not the role of airport operators to decide the location of new runway developments.
- 6.7. In 2003, the White Paper set out a strategic framework for the development of airport capacity over the next 30 years. Although the White Paper does not itself authorise or preclude any particular development, it provides airports in the South East and Scotland with the support needed to bring forward and deliver proposals for new terminal and runway capacity.
- 6.8. BAA is working vigorously to develop proposals for new capacity envisaged by the White Paper. These major projects represent important opportunities for BAA to develop its core business in a sustainable and environmentally responsible way. However, the new capacity will have significant impacts and the proposals are likely to be fiercely resisted by a wide range of opponents.
- 6.9. The Government's air transport policy framework will be a highly important component in BAA's efforts to deliver new capacity more quickly than in the past, by providing a clear, up to date and firm statement of Government policy. By clarifying Government policy and establishing national statements of need for major infrastructure projects, public inquiries will be able to focus on a much narrower range of issues.
- 6.10. In addition, new rules and procedures for planning inquiries have been established for major projects since the Terminal 5 Inquiry. BAA is optimistic that these changes will reduce the length of planning inquiries for major projects in the future – but notes that these new processes have not yet been used in practice.
- 6.11. Following the Barker Review of Land Use Planning and the Eddington Transport Study, the Government has recently published a White Paper 'Planning for a Sustainable Future'. This White Paper proposes to simplify and streamline the planning process for major infrastructure projects. The measures proposed include producing national policy statements for nationally significant infrastructure (including airports) and introducing a new system for dealing with major infrastructure projects incorporating an independent commission to take planning decisions.

- 6.12. These proposals build on the policy framework for airport development established by the White Paper in 2003, and confirmed by the DfT in 2006 in its Progress Report. BAA will be responding to the Government's consultation on the Planning White Paper, and we would welcome the Commission's contribution to this important debate.
- 6.13. BAA concludes that capacity constraints and development restrictions, taken together, are a feature of the market that potentially adversely affects competition. However, it should be recognised that action has already been taken by the Government through the Air Transport White Paper to address airport capacity constraints, and the changes that are now underway to improve the UK planning process have the potential to speed-up the delivery of major infrastructure projects.

7. Regulation

Summary

BAA agrees that regulation is a structural feature of the South East where there is potential to improve commercial relationships between airports and airlines. Recent experiences have shown how passengers could stand to benefit from a significant retraction, and in some cases complete withdrawal, of formal economic regulation by the CAA. BAA would encourage the Commission to consider opportunities for a new approach to regulation.

- 7.1. BAA agrees with the OFT that a full reappraisal of the regulatory regime that applies to BAA's London airports is warranted. The problems with the existing model are both serious and widespread, and there is a pressing need to improve the way in which airports are regulated.
- 7.2. Following privatisation, a simple and relatively light touch regulatory framework was adopted. However, subsequently this simplicity and light touch have been eroded as regulation has been progressively extended to address specific issues such as service quality, increased security requirements and capital investment.
- 7.3. Recent regulatory developments have also strained the current framework to breaking point. BAA is becoming increasingly concerned by the existing regulatory framework's inability to provide the continuity and stability that is necessary to incentivise investment in multi-billion pound airport projects. Further, the lack of regulatory guidance for runway expansion at Stansted has led to the existing framework being considered unworkable. This in itself raises concerns for the regulatory framework's ability to support major development at other airports such as a third runway and associated facilities at Heathrow.
- 7.4. In BAA's view a crossroads has been reached. One route would be towards intensive regulation of a type that has been applied in the utilities sector, incurring, we believe, higher costs than benefits. An alternative route would be to explore the opportunities for airports and airlines to reach agreements on a commercial basis, without recourse to intervention by the regulator.
- 7.5. The positive experience of constructive engagement in recent times demonstrates the major opportunities that exist to narrow the focus of regulation. Focusing regulation where its benefits exceed its costs would enable airports to respond more effectively to commercial incentives, and work more cooperatively with airlines for the benefit of passengers.

- 7.6. BAA believes that regulation should be substantially lightened - or even eliminated in some cases - and focused only on those areas where it is genuinely essential. In this regard, we welcome the steps already taken by the CAA and the DfT to review the designation and de-designation of airports.
- 7.7. The Commission should use the market investigation to explore opportunities to accelerate and extend this deregulatory process. In particular, the Commission should consider the benefits of a substantial retraction of the scope of regulation, either through formal de-designation or, where continued designation is warranted, re-establishing the role of the regulator to be a 'back stop' to normal commercial interaction.
- 7.8. We conclude that the regulatory framework is a feature that potentially prevents, restricts or distorts competition.