

CONFIDENTIAL

Response for BAA Limited

Comments on BA's response to  
Emerging Thinking

BAA/CC2008/1109

BAA Limited  
August 2008

## BAA's Response:

1. This document provides a response to some of the issues raised by BA in submissions to the Commission.

### **Sequential development**

2. In its Emerging Thinking, the Commission have appeared to accept the views put forward by BA, who claim BAA has a sequential approach with respect to development at its airports. In BAA's response to Emerging Thinking (BAA-CC2008-800 paragraphs 7.78-7.79) BAA has set out reasons why it does not accept the Commission's Emerging Thinking.
3. Since Emerging Thinking, BA has further made this same claim that BAA approach development sequentially.<sup>1</sup> BAA therefore felt it timely to supplement this response.
4. Annex 1 includes a high level description of substantial capital projects undertaken since privatisation at the three London airports and the level of capital expenditure associated with these projects. This diagrammatic representation clearly demonstrates numerous parallel projects underway by BAA.

### **Transfer passengers and under-investment**

5. In its response to Emerging Thinking (and in other submissions to the Commission), BA alleges that Heathrow does not compete effectively for transfer passengers with other European hubs and this is a cause of BAA's "chronic under-investment." As a consequence of the under-investment, BA argues that BAA had no margin under which they could respond to the increases in security requirements in 2006/07. BA goes on to note that BAA's incentives to compete with other hubs for transfer traffic are weak and BAA is protected from this competition.
6. BAA recognises the fundamental importance in investing in airport capacity. Elsewhere, BAA has demonstrated that there are a number of reasons which have delayed the introduction of additional capacity, for example, the planning regime causing delays to the delivery of Terminal 5. Given the constraints that BAA operates in, BAA believes that there has been no failure to under invest in such facilities.
7. BA has argued in this response and past submissions, including the previous quinquennial review, Q4, that BAA under invested in facilities. BAA's expenditure is subject to regulatory oversight, and such allegations were investigated as public interest issues in the last quinquennial review where the Commission concluded that BAA's investment performance

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<sup>1</sup> See paragraph 3.2 which notes that sequential development is characteristic of BAA.

had been broadly satisfactory aside from the delays at Terminal 5, these delays were acknowledged by the Commission as being largely outside BAA's control.<sup>2</sup>

8. BAA also finds BA's allegation of under-investment in facilities for the airline extraordinary given the recent opening on time and on budget of the £4.5b Terminal 5. Without wishing to labour an issue that has been previously scrutinised in considerable detail, at the outset of Q4 BA's intention was for a phased transfer across of operations into Terminal 5; as a consequence the Q4 price path reflected spend on the project being phased over Q4 and Q5. Early into the quinquennium, BA changed strategy in favour of a single move in 2008 – BAA's response was to bring forward expenditure to support the airline's tactics. In consequence BAA delivered an investment programme far in excess of that envisaged and provisioned for in the Q4 price settlement.
9. During Q5 review, BAA's capital expenditure was agreed with the airlines through the CAA-sponsored Constructive Engagement process. As a result of this process, the requirements for new/refurbished facilities were debated with the airline community and this served to usefully highlight the competing pressures on developing a mutually endorsed plan of investment
10. BA refer in their submission to a lack of investment in transfer facilities, yet little mention is made of the difficulty experienced in gaining endorsement from across the Heathrow airline community to projects that support the connections process. From before the outset of Constructive Engagement both BA and BAA have promoted the inclusion in the expenditure plan of the £240m inter-terminal baggage connectivity project. BA are acutely aware that for an equally long time period the STAR alliance have been less than enthusiastic supporters of this investment and ultimately petitioned the CAA to disallow this expenditure from the RAB. BAA has been unstinting in its attempts to present the argument in favour of the project to the whole of the airline community and to secure regulatory endorsement.
11. BAA was therefore satisfied when the CAA supported the inclusion of this project into the investment plan for Q5, concluding that

*8.29 This project has strong support from airline representative bodies (both in terms of scope and timing and in terms of funding through the RAB), which reflect the balance of (conflicting) individual airline views. In terms of Star Alliance's preference for intra-HET connectivity in advance of inter-terminal connectivity, the CAA's consultants Currie & Brown concluded in November 2007<sup>3</sup> that the Star Alliance's preferred option was not physically possible in terms of construction*

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<sup>2</sup> Paragraph 2.406

<sup>3</sup> Supporting Paper I – Review of Heathrow Capital Investment Plan for Q5 and Q6, Currie & Brown, November 2007

*sequencing, and was not being held back by an artificial budget constraint or bias towards other projects.*

12. In reference to the 2006/07 security requirements which BA argue shows there was room for an adequate response by BAA, BAA considers that the additional security requirements highlighted the lack of spare capacity in Heathrow's facilities. However, the fundamental cause of the lack of spare capacity can be attributed to a number of reasons which BAA considers need to be understood, and which show that it is not reluctance on BAA's part to invest in capacity.
13. Finally, BA's submission includes an annex and appendices which contain further information regarding BAA's forecasts included apparently to support BA's claim that BAA has under-invested in transfer facilities. The final section of this response sets out comments on BAA's alleged under-investment in transfer facilities.
14. BAA believes that in BA's response, there are some misrepresentation of some facts; and a failure of acknowledgement that BAA concurred on some of the arguments put forward by BA and the next section provides comments on the annex and appendices.

#### *Annex 1*

- In section 1 of Annex 1, BA's response is consistent with what BAA said at the Terminal 5 Inquiry as noted in the second paragraph of section 3.

#### *Appendix A*

- Several times in section 3 of Annex 1, BA notes that BAA assumed 12.5 per cent transfers in a 60 mppa no T5 world. This wholly misrepresents BAA's forecasts. Attached to BA's submission in appendix 1 is BAA's Inquiry Document (BAA/2009) and this shows:
  - a) That the 12.5 per cent was a sensitivity test for the specific purpose of examining a worst case for the surface access impact of Heathrow (i.e. the lower the transfer per cent the more people are non-transfers and therefore driving cars etc). BAA deliberately chose a low figure for transfers in this instance so as not to be accused by T5's opponents of understating worst case surface access impacts.
  - b) BAA's main case was for 20 per cent transfers in 2016 when Heathrow was handling 80 mppa with T5. BA's own forecast for precisely the same scenario was 22 per cent (see table at para 9). BA's no-T5 transfer assumption was 17 per cent (same table).
- Further, BA shared BAA's view on a with -T5 world that even with T5 by 2016 the constraints arising from the existing runway capacity would reduce the transfer per cent from contemporary levels - to a level very close to BAA. BA also believed that without T5 the transfer per cent would further reduce.

*Appendix B*

- BA's allegation that BAA has under-forecast transfer passengers is simply untrue as shown in the document provided by BA. In the table 1 of this paper, BAA's forecasts were predicting that the first full year of T5 (2009) a transfer proportion of 32 per cent. For the first six months of 2008, it has actually been 34 per cent. BAA would consider the difference hardly a significant under-forecast.
  - Further, it remains BAA's view that faced with the increasingly constraining effect of the 480,000 movement cap, the transfer percentage at Heathrow is likely to decline from its current level and 26% by 2016 remains a distinct possibility.
15. One further point BAA would like to make, is in the main paper (paragraph 5.5), BA argue that transfer passengers contribute disproportionately to BAA's overall profitability.
  16. BAA disputes this allegation and would ask BA to demonstrate that after normalising for length of haul (transfers account for a higher per cent of long haul passengers than they do short haul) transfer passengers make a greater contribution. On this basis, BAA would also dispute the fact that BAA does not have sufficient incentives to invest in transfer facilities.