

**IATA and BARUK response to the UK Competition Commission (CC)
Market Inquiry of 11 April 2007 into the supply of airport services by BAA
within the UK**

Summary

- Airlines require improved cost-efficiency and value for money from airports that provide essential services and facilities within the industry supply chain.
- We do not believe the outcomes of the economic regulation regime are fit for purpose.
- A summary of our 18 August 2006 and 5 February 2007 papers with our views and requirements for the OFT UK Airport Market Study are provided in this response.
- We do not believe the current structure provides the best incentive to expand airport capacity in S. E. England
- We fully agree with the OFT preliminary finding that there are grounds to believe that BAA's high regional market shares, the system of economic regulation of airports, and capacity constraints combine to prevent, restrict or distort competition with adverse consequences for customers and consumers using these UK airports.
- We also agree there is a reasonable prospect that appropriate remedies would be available if the CC were to find an adverse effect on competition, and that these may take the form of requiring BAA to divest some of its airports, or recommendations regarding the regulatory system, or both.
- We therefore welcome the in-depth inquiry by the Competition Commission into the supply of airport services by BAA within the UK.

1 Introduction

1.1 The International Air Transport Association (IATA) with the support of BAR UK welcomes the opportunity to respond to this Market Inquiry. IATA is the trade association representing 250 worldwide members who provide 94% of all international scheduled traffic. The Board of Airline Representatives in the UK (BAR UK) represents 91 airlines in the UK in their dealings with Government, regulators and airport operators. With some 130 of our members using UK airports we clearly have a significant interest in this issue.

1.2 In our responses of 18 August 2006 and 5 February 2007 to the Office of Fair Trading (OFT) we fully supported a reference to the CC for an in-depth investigation of the extent to which the BAA is abusing its market strength and position, particularly in S. E. England.

2 IATA and BAR UK views and requirements

2.1 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.

2.2 Airlines are responding to increasingly intense competition and liberalization by significantly improving cost-efficiency. We have reduced non-fuel unit costs some 14% over the last five years, with a 33% improvement in labor productivity. While the drop in fuel price from its peak level in August 2006 is welcome it is still more than twice as much as we were paying in 2001 and represents some 26% of our total costs. Competition has driven down our real yields some 30% over the last 10 years. Airlines are continuously reducing costs in line with consumers' demands.

2.3 Unfortunately we are seeing nowhere near this improvement in efficiency from our key airport partners within the supply chain who enjoy a relatively stable and growing revenue base. Aviation is a major contributor to economic growth and development. More than ever we need support to ensure the lowest possible costs and charges consistent with the provision of the agreed necessary capacity and service. In our view we have not seen strong enough incentives for the BAA airports to achieve efficiencies and value for money.

2.4 Our response of 18 August 2006 to the June 2006 OFT Market Study on the UK Airports can be summarized as follows:

- We believe this market study is necessary and timely against the background of:
 - BAA's 92% passenger market share in S. E. 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 travelers.
 - The outcomes of the Ferrovial bid for BAA
 - We are currently engaged in the CAA and CC review for the 2008-13 London Airport price caps.
- During the review for the 2003-07 airports price cap we had suggested to the CAA and CC that consideration should be given to the possible hiving-off of LHR or LGW airports, and for competition within airports as a means of improving cost-efficiency.
- The economic 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.

- 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 traveling 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 S. E. England.

2.5 The summary of our response of 5 February 2007 to the December 2006 OFT UK Airports Market Study is as follows:

- We fully support the provisional conclusion of the OFT to refer the supply of airport services by BAA within the UK to the Competition Commission (CC) for a market investigation.
- We do not believe that the current system of airport economic regulation is fit for purpose - airport ownership may not be the major issue if economic regulation can be significantly improved to provide the appropriate remedies.
- We fully support the OFT recommendation for Government to publish clear criteria for de-designation of airports plus criteria and guidelines for re-designation.
- We have reservations on the possible de-designation of Manchester Airport until such time as the Government has published criteria for de-designation, and more importantly provides an indication of the conditions and process for re-designation.
- We do not believe Government should consider transferring decisions on designation to the CAA

3 Investment

3.1 We also welcome the CC inquiry in view of our concern that the current structure may not provide the best incentive to expand airport capacity in S. E. England. This issue was raised in our response to the CAA initial proposals of December 2006 for the London Airports price control review.

3.2 Our concern is that BAA may be incentivised by the objective to optimize shareholder benefits by using investment to maximize the guaranteed return on its regulated asset base (RAB) and may be less motivated on where the investment takes place.

3.3 Consequently this may lead BAA to pursue investment where it is easiest to achieve but not necessarily where it most meets the needs of customers for the timely, efficient and cost-effective investment in new airport capacity. In principle we are concerned that all major development opportunities should not be in the hands of a single company that has no statutory obligations in this regard.

3.4 We believe that independent economic regulation is necessary and desirable to incentivise the airports to deliver continuous improvement in cost-efficiency and service quality. Airports, particularly busy and constrained LHR and LGW, are natural monopolies providing essential services and facilities for the airlines, and market forces do not necessarily or adequately discipline such monopolies. The regulation however, should ideally be more simplified, less costly and resource intensive.

4 Office of Fair Trading reference to the Competition Commission

4.1 We note that the evidence and preliminary findings of the OFT report of April 2007 on its reference to the CC very much reinforce our views and requirements. We fully agree that there are reasonable grounds to suspect that BAA's high regional market shares in S. E. England and Lowland Scotland, the system of economic regulation of airports, and capacity constraints combine to prevent, restrict or distort competition with adverse consequences for customers and consumers using these UK airports.

4.2 We agree there is a reasonable prospect that appropriate remedies would be available if the CC were to find an adverse effect on competition, and that these may take the form of requiring BAA to divest some of its airports, or recommendations regarding the regulatory system, or both.

5 Competition Commission Market Inquiry

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.

Geneva 4 May 2007