Competition Commission

Supply of Airport Services in UK by the BAA

The Response of the Transport and General Workers' Union Section of Unite the union

May 2007

Summary of the main points of the T&G Section of Unite the union submission.

- We believe that the aim of increasing competition between airports is not likely to be achieved by the divestment of BAAs London Airports. In fact as a result of competition prices could actually increase.

- The current ownership of the London regulated airports should be maintained. We believe the break-up of the BAA owned airports would act against the interest of the customer and could result in increased prices.

- Customer services levels and staff moral could be affected by any divestiture of a London airport

- There should be no decision on breaking up the London Airports until a proper cost benefit analysis is undertaken and the findings of which resulted in conclusively establishing the benefits of the break-up of the BAA London airports

1 Introduction

The Civil Air Transport (CAT) Trade Group of the Transport and General Workers' Union (T&G) Section of Unite the union is an independent trade union, and 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.

Our current membership in our CAT Trade Group is over 50,000. We represent a large number of people employed in all the regulated airport. These members are employed directly by the airport owner or they are working for companies who supply services in the airports, or are working directly for airline companies.

The CAT Trade Group of the T&G Section of Unite the union would welcome the opportunity to answer any questions relating to our submission, no part of our response is confidential, and our contacts are:

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2 Ownership of the Main London Airports

One of the perennial competition issues in regard to BAA is its ownership of the three main London airports, and whether this acts against the interest of the consumer. 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 comments was also made about BAAs Scottish Airports in paragraph 9.11.

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 stated: 'As we noted in our previous report, separate ownership of airports could only be put forward by ourselves as a remedy if it were relevant and proportionate to any adverse effects identified, for example, if BAA should fail on a significant scale to invest adequately or achieve appropriate service standards,. However, given that in most circumstances competition is likely to have important benefits for consumers, this may, nonetheless, be an issue for further consideration by Government at some point in the future once plans have been settled for runway capacity in South-East England, or should there be any other significant change in the circumstances of the air transport industry' .

In the 2002 CC report on the BAA price controls 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.

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.

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.

This we think is a simplistic and naive argument.

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 per cent in 2005; 95 per cent 1990) (OFT

2006: 2). While it is true that the BAA has a local monopoly for airports serving London, it does not have a wider monopoly and it is not the most expensive of of the four FLAP[1] airports.

Airport	Index	Ranking
Paris – CDG	77	7
Frankfurt	72	9
Amsterdam	69	12
London – LHR	58	27
London – LGW	*35*	44

Table 2.1 Source: TRL Airport Charges Index 2005

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 business 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.

Also competition is coming from outside of Europe for example Dubai is increasing becoming a competitor to Heathrow.

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 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

Thirdly, those 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 has neither.

Given that these airports are regulated and their prices set by the CAA and the Competition Commission. 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 its various aviations policies controls the number of airplanes using the London airports.

Also 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. It is 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

[1] The FLAP airports are: Frankfurt; London; Amsterdam; and Paris

between these airports and it would be difficult to see an economic regulatory role in this situation could be maintain at its present level. Indeed it is quite possible that airport landing charges would increase. 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 last week’s hectic bidding for BAA…’ (Done July 2006). In the financial year 2004-05 Gatwick Airports ebitda was £172.1m resulting in a market value of £2.581b. 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 £1b more than its Rab [regulated asset base] value…’ (Osborne 2006). The 2006 estimated Rab for Gatwick is £1,6b.

In the current global economic situation we believe that at this market price BAA would have little or no problems selling Gatwick Airport. Many private equity firms and other institutional investors, especially pension funds would be interested in purchasing Gatwick.

There is also the real possibility of increased prices, especially at Gatwick airport, if the London airports were broken up. This was recognised by the MCC 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. 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…’

Therefore we have to ask would breaking up these airports actually result in a misallocation of resources? This 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.

Also the CC has to recognise that due to the existence of high ‘sunk costs’ the airport market it is unlikely that the airport market could ever 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 create a barrier to entry, and if the planned expansion anticipated by the Aviation White paper goes forward, even higher sunk costs will exist.

Another barrier to entry, which the OFT recognises is the long-term planning restriction in 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.

Therefore we believe 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.

The regulatory environment creates a positive environment that it provides certainty. 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 and probably at a more advantageous rate on the capital markets.

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).

Gross debt at 31March 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.

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).

3 Conclusions

Therefore the T&G Section of Unite the union believes it is in the wider public interest that the ownership of the main London Airports should remain with the BAA.

We believe the break-up of the BAA owned airports would act against the interest of the customer and could result in increased prices and a reduction in customer service levels at any divested airport.

There should be no decision on breaking up the London Airports until a proper cost benefit analysis is undertaken and the findings of which resulted in conclusively establishing the benefits of the break-up of the BAA London airports

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