



4 May 2007

Julie Hawes  
Airports Inquiries Coordinator  
Competition Commission  
Victoria House  
Southampton Row  
London  
WC1B 4AD

Dear Ms Hawes,

#### MARKET INQUIRY INTO THE SUPPLY OF AIRPORT SERVICES BY BAA WITHIN THE UK

Thank you for your letter of 11<sup>th</sup> April 2007 inviting representations or information on matters relevant to the market inquiry into the supply of airport services by BAA within the UK. Virgin Atlantic welcomes the Office of Fair Trading's [OFT] reference to the Competition Commission for an investigation into the supply of airport services by BAA and the opportunity to provide comment on this subject.

Virgin Atlantic operates 37 aircraft serving 30 destinations worldwide from Heathrow, Gatwick and Manchester airports plus a limited operation from Glasgow, carrying four and a half million passengers through these airports in 2006. Consequently the Competition Commission's market inquiry into the supply of airport service by BAA is of considerable interest to Virgin Atlantic.

Virgin Atlantic only operates a limited service from Glasgow. As such, the comments in this response are predominantly focussed on the supply of airport services by BAA in the South East of England.

During 2006 and 2007, Virgin Atlantic has responded to a number of consultations on various matters relating to Heathrow and Gatwick Airports, including evidence for the OFT's market study of UK airports [August 2006] and commentary supporting the OFT's proposed decision to refer to the Competition Commission an investigation into the supply of airport services by BAA [February 2007]. I enclose copies of our correspondence with the OFT for your convenience.

Virgin Atlantic has always promoted the establishment of competition as a means of minimising costs, maximising efficiency and delivering the quantity and quality of service which customers require. As such, Virgin Atlantic would advocate the divestment of one or more of BAA's South East Airport's, alongside continued economic regulation, to maximise competition and its associated benefits. Virgin Atlantic also recognises the benefits of inter-

terminal competition within an airport. At JFK airport in New York for example, inter-terminal competition has enabled carriers to select which terminal they wish to operate from based on price, the facilities package available and the quality of service. However, inter-terminal competition is not without its difficulties. At capacity constrained airports such as Heathrow, sub-optimal utilisation of facilities could offset at least some of the gains from competition, as efficiency may not be maximised. However, Virgin Atlantic welcomes the Competition Commission's inquiry into the broad range of structural remedies that maximise competition and its benefits, and restrict BAA's (or any other organisation's) ability to prevent, restrict or distort competition to the detriment of airport passengers and users.

In general, Virgin Atlantic wishes to highlight the OFT's declaration that 'given BAA's joint ownership of airports in the South East is a situation which has existed for over two decades, assessing what would occur in its absence is a difficult question and one perhaps more suited to the more in-depth investigation offered by the Competition Commission. We have, however, reviewed as hypothetical, whether a merger or series of mergers of these airports would be likely to trigger the OFT's duty to make a reference to the Competition Commission under the merger provisions of the Enterprise Act 2002. We have concluded that the OFT's duty would likely to be triggered'<sup>1</sup>. Although only a crude assessment, this indicates that the ownership structure of BAA airports in the South East may act to prevent, restrict or distort competition, and that without the Airport Act [1986], competition legislation would not have permitted the situation to evolve to the position that BAA enjoys today.

Alongside the other issues highlighted by the OFT, Virgin Atlantic supports the three major themes identified by the OFT in its reference to the Competition Commission which are suspected of preventing, restricting or distorting competition, either individually or in their interaction.

### Joint Ownership

Virgin Atlantic recognises that revisions to the economic regulation of airports in recent years, notably the ring-fencing of airports preventing financial cross subsidy, have gone some way to protect users from the perverse consequences that the joint ownership of BAA's South East airports might have caused. Virgin Atlantic is pleased to note that despite this mechanism, the OFT recognises that BAA's sustained 'group management' mentality continues potentially to distort investment decisions (even though each airport has its own profit and loss account). A continued 'group management' mentality, whereby BAA considers the impact of its decisions across its portfolio can potentially result in sub-optimal decision making patterns, particularly in relation to the quantity and quality of capital investments, at the expense of users and passengers of a specific airport. Virgin Atlantic recognises that no matter how stringent, economic regulation cannot fully protect users against monopolistic behaviour such as this.

### Development Restrictions and Capacity Constraints

<sup>1</sup> BAA The OFT's Reference to the Competition Commission [April 2007], para. 8.7.

Virgin Atlantic agrees with the OFT's concern that 'in the South East of England, BAA's ownership of Heathrow, Gatwick and Stansted limits the competition between airports to promote the delivery of extra capacity in a timely cost effective manner'<sup>2</sup>. Particularly in the South East, Virgin Atlantic is concerned that the ownership structure will not maximise the community economic benefits of any increased capacity as BAA seeks to maximise on its own financial return. Such a conclusion is supported by BAA's stated requirement for 'an appropriate settlement' within the discussions relating to the next price control period.

In addition, in the long run the majority of much needed airport development and expansion in the South East of England is destined to take place at BAA owned airports. Virgin Atlantic is concerned that development restrictions alongside the current ownership structure of BAA's airports will mean that airlines will continue, and perhaps increasingly, to be held hostage to BAA's internal strategy and BAA's ability to exercise overwhelming monopolistic behaviour.

### Regulatory Regime

It has been an ongoing concern for Virgin Atlantic that the current regulatory framework is not sufficiently robust to provide suitable protection for airport users and passengers. In particular, Virgin Atlantic believes the current regulatory regime does not offer adequate safeguards against inappropriate investment decisions by BAA, particularly the tendency for BAA to 'gold plate' capital investment projects. In addition Virgin Atlantic, along with other airlines, believes that the current regulatory regime presents BAA with the opportunity to undertake 'regulatory gaming' to maximise its own financial return. VAA is concerned that the current structure of the regulatory system creates an environment in which BAA can further exploit its monopoly status.

Virgin Atlantic recognises that it is not the Competition Commission's duty within this study to investigate the course of conduct that BAA has pursued in relation to the quinquennial price control reviews. [VAA has submitted separate evidence to the Competition Commission relating to the fifth quinquennial review]. However Virgin Atlantic suggests that the pricing and service quality difficulties that airlines, passengers and other airport users experience are indicative of the underlying structural issues of airport service provision, particularly in the South East of England.

Virgin Atlantic wishes to reiterate that even if the Competition Commission were minded to propose divestment of BAA's assets, in whatever form this might take, to correct BAA's ability to prevent, restrict or distort competition, this does not mitigate the need for economic regulation of each airport. Each airport would continue to exercise significant monopoly power and despite the difficulties of the current economic regulation system, it is the only protection mechanism available to protect airport users and one that Virgin Atlantic wishes to see maintained.

Virgin Atlantic welcomes the broad scope of the OFT's reference to the Competition Commission, indicating that a basic market study is not sufficient:

<sup>2</sup> BAA The OFT's Reference to the Competition Commission [April 2007], para. 17

to address fully all of the issues. Virgin Atlantic fails to recognise significant economic benefit from the joint ownership of Heathrow, Gatwick and Stansted by BAA and believes it timely that a comprehensive review of whether the current portfolio of airports that BAA holds in the South East of England, or will continue to hold, is in the public interest.

Virgin Atlantic welcomes the wide scope of available remedies the OFT has suggested to address the ability of BAA to prevent, restrict or distort competition. Virgin Atlantic believes that passengers should be able to benefit from increased competition in the airports sector, as has occurred through liberalisation of the airline industry. Virgin Atlantic urges the Competition Commission to invoke the most stringent of the remedies it considers necessary to protect airlines and passengers from BAA's ability to exploit its market power, and enable the benefits of increased competition and improved service quality to be transferred to airlines and passengers in the long term.

Virgin Atlantic looks forward to assisting the Competition Commission throughout its investigations. I trust that you find this submission useful. Please feel free to contact me if you require any further explanation.

Kind Regards

Nigel Milton  
Manager, Government and External Affairs