6 Views of the main parties

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Introduction

6.1. This chapter summarizes the views of BIA, and Shorts and BCA, which they provided to us in written submissions and at hearings.

BIA

Background to BIA's proposal for the purchase of BCA

Operational considerations

6.2. BIA attributed the emergence of the City Airport in 1983 to two principal reasons: first, the attitude of the then public sector management of BIA which was not sympathetic to small airlines and did not appreciate the commercial opportunities they presented; and second, the existence of another runway and control tower at Shorts where a commercial airport operation could be run as an ancillary business. BIA alleged that the City Airport had not entered the market as a free-standing commercial airport responding to customer demand.

6.3. BIA stated that it had made an indicative proposal to purchase BCA because it saw a commercial opportunity to acquire a company with total synergy with its own business. BIA had made its unsolicited offer to Shorts after Shorts had signed a heads of agreement for a sale to Sarcon. The background to this is set out in Chapter 3. BIA emphasized that whether or not it purchased at the end of the day depended entirely on due diligence. It had not yet had sight of any details from BCA other than published data.

6.4. The bid originally made by Sarcon was understood to include the Sydenham site. BIA explained that on 2 May 1995 it had made an indicative bid for BCA and the Sydenham site at a price in the range £25 million to £27 million subject to due diligence. It had no access to detailed information about the City Airport or the value of the Sydenham site and had pitched its bid at a level above that of Sarcon as a means of entering into negotiations. It did this in the knowledge that its unique ability to access synergies of around £[*] meant that it could pay more than other bidders.

6.5. BIA believed the level of traffic currently handled by the City Airport put it at the limits of the constraints imposed by the Harbour Plan. It expected traffic for both the Belfast airports combined to grow at an annual rate of the order of 3.2 per cent. This would imply either that the additional traffic would need to be accommodated at the International Airport, or that the planning constraints at the City Airport would need to be challenged and relaxed. BIA was not sure whether the planning restrictions could be eased. Noise, for example, was likely to be a continuing problem for the City Airport. A US consultant had pointed out that even if it could be shown scientifically that the level of noise had reduced around an airport, the number of complaints tended to increase when traffic increased. Noise was often a surrogate for concerns about safety.

6.6. BIA's general strategy for the two airports would be to maximize volume and revenue while accessing synergies. Maximizing volume would imply recognizing the value attached to the choice offered by the City Airport for some airlines and passengers. This value had been shown by the way the City Airport had expanded the overall Belfast market. The number of passengers flying to and from Belfast grew by an average of 8.1 per cent a year between 1983 and 1990 compared with 6.6 per cent a year for the UK as a whole. However, growth since 1990, at 3.3 per cent a year, was below the UK average of 4.8 per cent a year.

6.7. BIA said that it would be in its interests to keep the City Airport open. If the City Airport were closed or downgraded in importance, additional traffic would be lost. Specifically, BIA pointed to the airlines' assertions that they would not transfer to the International Airport should the City Airport close, as this would entail losing their key locational advantage and would force them to compete head-on with BA and BM.

BIA's long-term intentions

*Details omitted. See note on page iv.

6.8. BIA told us that if the merger came about it would operate both airports as an integrated transport system. Putting both airports together under common ownership would not change the decisions taken by airlines. BIA could not get into the business of rationalizing or redistributing traffic; that was an airline decision. In a merged situation, BIA would be interested in volume growth at both Belfast's airports. The operation of the City Airport would be discussed with the airlines which operated there. If they and others wanted to expand operations, there would be pressure on BIA to seek to change the planning constraints. BIA subsequently confirmed in writing that under single management the two operations would be kept separate, and that each airport would remain open subject to *force majeure* incidents beyond BIA's control, for as long as airlines were willing to pay charges which kept the business economically viable. BIA added that at the moment it did not know precisely what the charges at the City Airport were; but it would hope, subject to due diligence, to honour existing airline deals.

6.9. If smaller planes were replaced by larger planes, the number of ATMs would decrease. This might be a significant factor in considering the future of the City Airport, where the planes were for the most part small. BIA had a vision of a single airport centre in Belfast, whether this amounted to two terminals of the same airport or two airports under common ownership. If the airports remained in separate ownership and things continued as they were without rebalancing between the two airports, there would be no way of achieving a concentration which attracted greater contributions from the international market (see paragraph 6.14). BIA could see advantages in a Terminal A and a Terminal B approach to managing the Belfast airports: BIA would be able to provide city centre check-in and a dedicated shuttle service between both airports, with a travel time of the order of 25 minutes.

6.10. BIA said that if it owned both airports and it found that its airline customers strongly favoured an expansion of the City Airport, taking into account the relative investment needs at each airport, it would seek a relaxation of the planning constraints in order to maximize volume and revenue. Unlike other bidders, however, BIA would not see this as imperative to the financial viability of the City Airport. If activity there were to stay at its present level, BIA believed it should be a profitable operation (this would be verified by due diligence). Future expansion could be handled at the International Airport, boosting BIA's overall profitability. By contrast, an independent operator might well need to see traffic expand significantly at the City Airport in order to recoup its investment. While it could not be sure, BIA thought Sarcon's decision not to progress its bid might have resulted from a realization that the planning constraints would impose an impediment to growth. In addition, it would have discovered that the land available was on a very restricted base.

Financial matters

6.11. BIA said that it was required to pay a fee of £5 million to the Government in the event that it acquired the City Airport (or vice versa) within ten years of privatization. It believed the Government envisaged that at some future time it was possible that the two airports would come under common ownership and wished to ensure that, in the event of this happening, some of the benefit of cost savings resulting from the merger would be shared with the public. The condition might also have arisen because in the early stages of privatization Shorts had expressed an interest in acquiring the International Airport, having previously been the recipient of substantial public funds over the years.

6.12. In about 1986, just prior to the sale of Shorts to Bombardier, BIA had been in discussion with BCA with a view to running both airports in public ownership. In the present case BIA's bankers and investors supported the company in pursuing this opportunity, subject to review of the business case, recognizing that it offered a significant opportunity to expand and grow BIA's business. The two airports were only 17 miles apart and BIA claimed that they were closer in terms of journey time than Heathrow's Terminals 1 and 4.

Investment needed at the City Airport

6.13. Until it had the opportunity to review more detailed information on the City Airport BIA could not say anything definite about its plans. It believed some expenditure would be needed to maintain, and in some cases improve, facilities. BIA was not in a position to put a figure on that expenditure, but it believed some work needed to be done on car parking and the terminal building. It did not know the state of the runway but was aware that little or no work had been done on it for about 20 years. If the merger went ahead, BIA would plan to talk to the airlines using the City Airport to establish what work they thought needed to be done. Local consumer groups had called for improvements to the facilities at the City Airport, perhaps on the basis of comparison with the International Airport.

BIA's offer

6.14. BIA told us that the premium of between £1 million and £3 million which its offer reflected over the Sarcon bid of £24 million was not material; it had deliberately offered at a higher level as a negotiating ploy and due diligence was a precondition of any bid. Nevertheless, it did believe there would be operational synergies and cost savings available to BIA and not to other bidders. The advantages of a merged enterprise were that, first, [*] could be made. Second, BIA believed there was a very direct benefit for air services in Northern Ireland from presenting Belfast as one market: this could not be done effectively with two separately owned airports. That was why international services out of Belfast had not grown at the same rate as they had at other regional airports in the UK. Newcastle Airport provided quite a good analogy: it had a similar hinterland in terms of size of population to Belfast, yet catered for around 316,000 international schedule passengers against only 48,000 at BIA. This was because the splitting of domestic flights between the two airports had prevented the International Airport from achieving the critical mass of passengers necessary to attract the international airlines.

Markets

Introduction

6.15. BIA stated that competition in airline markets was complicated because of the interactions between airports, airlines and air passengers. The role of airports was as set out in the Government's White Paper on airports policy (June 1985, Cm 9542), paragraph 10.1: `Airports are not an end in themselves: they exist to support air services.' Airports were air transport facilitators. They became of significance in the transport network only once an airline had decided, in the light of its analysis and perception of passenger demand, to serve a particular destination. Airlines were thus the primary users of airports, and the decision whether and when to serve a particular destination was in the hands of the airline. Only once a service was offered by the airline did the airport become of significance to passengers. Passengers were thus the secondary users of airports.

6.16. BIA stated that airports did compete, primarily to attract the airlines and secure lucrative routes. Once routes were established, airports tried to encourage high frequency and maximum passenger throughput. However, this competition between airports was not relevant in the case of the International and City Airports. It was in the nature of the services provided and the profiles of the two airports that they simply did not compete in any conventional sense. This could only be understood through a full analysis of the economics and the services provided at each.

Geographic market

6.17. BIA said that defining the relevant geographic market was complex because of the different requirements of passengers and of airlines. For charter and international flights, the International Airport's catchment area was likely to be Northern Ireland and a material part of the republic. For domestic scheduled flights, the catchment area was the whole of Northern Ireland and parts of the republic. Surveys of cars parked at the International Airport had shown that not less than 25 per cent of the cars parked came from the

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*Details omitted. See note on page iv.

Republic of Ireland. Both airports attracted passengers from mainly the Belfast area but passengers close to BIA would generally prefer the International Airport and similarly passengers in the city and North Down area, for whom the City Airport is closer, would be likely to prefer that airport. Indeed, BIA told us that the differences in airport access times for passengers were material in relation to overall journey times and it noted that airlines had also made this point in their submissions.

Product market

6.18. BIA told us that airports served four principal product markets: cargo, international scheduled, charter and domestic scheduled. The City Airport was relevant only in the last segment as it did not operate any material services in the other markets. Also the City Airport could handle only small aircraft, and, unlike BIA, was restricted in terms of its operating hours and its ability to provide a service in all weather conditions. For these reasons, BIA thought it could be said that BCA operated in a segment of the market that was only a subset of the domestic scheduled market. The degree of overlap between the two airports was thus, in BIA's view, small.

Competition

Competition between airports for airlines

6.19. BIA submitted that a superficial inquiry into the effects on competition of the merger would wrongly assume that it was an open and shut case. It would presume that the airports must compete, and that this would take the form of keeping prices keen and quality high, to attract airlines and passengers. On this assumption a merger would therefore appear to be against the public interest because of the reduction in competition. Such a conclusion would imply that either airport could, by reducing charges or improving services, attract more airlines and passengers to use its airport. Only if this were feasible would there be any incentive to be competitive in terms of price and quality.

6.20. BIA submitted that there was no effective competition between the International and the City Airports. In a significant part of the International Airport's market there was no overlap with the City Airport; and in that part where there was overlap (scheduled domestic services), while airlines and air passengers did exercise a degree of choice between the two airports, the fundamental factors influencing those choices were not those which were within the control of airport management, but related rather to questions of airline economics and competition. Because the factors which influenced airline choice were outside airport management control, and those factors within management control such as price and quality of service were highly unlikely to influence this choice, it followed that neither of the Belfast airports was under pressure to keep prices low and improve service quality directly as a result of the presence of the other airport. BIA emphasized that it was not suggesting that there were no benefits to airline passengers associated with having two airports in Belfast. For some airlines the City Airport had been seen as a favourable location because it had welcomed the smaller aircraft which had not been encouraged by the previous public sector management at the International Airport. That was why the City Airport had attracted new routes and had contributed to the high growth observed in the Northern Ireland domestic air market since the City Airport entered (115 per cent growth between 1983 and 1994 compared with 72 per cent for the rest of the UK). However, this growth had been due to the new opportunities arising when the City Airport opened, not the ongoing effects of `competition'. BIA was not suggesting that its management had been indifferent to the growth of traffic at the City Airport; but BIA had been unable to do anything to influence airline choice.

Airlines' choice of airports

6.21. BIA told us that airlines had a valuable and scarce resource (their aircraft) and sought to utilize this in the most profitable way possible. The key factor which determined airline choice of airport was route profitability, which in turn was dependent on traffic density, yield and inter-airline competition. Airlines could only serve airports where essential services were provided (for example, adequate runway length). Beyond this, however, they attached relatively little importance to other aspects of airport service quality or to the level of airport charges. It was highly unlikely that these factors could appear sufficiently favourable to alter an airline's choice of airport: this was based on the fundamental route characteristics of density, yield and inter-airline competition. At the margin, however, where airlines considered incremental changes in their pattern of operation, for example to switch an aircraft to rebalance frequencies on two of their existing routes, airport charges might play a role in their decisions. In addition, there could be genuine competition between rival hub airports (for example, between Heathrow and Schipol) and between airports trying to attract long-haul or charter traffic, since this traffic was less time-sensitive and passengers might be willing to travel to an alternative airport for cheaper flights. In BIA's view, the implication of this for Belfast was that there was no effective competition even for those services where there was overlap.

6.22. In choosing whether to run services to and from Belfast, airlines considered whether other, more profitable routes were available on which to deploy their aircraft, whether in the UK, or indeed, world-wide. In other words, they considered the opportunity cost of using their aircraft on the Belfast routes. Once the decision had been taken to serve Belfast, the next choice was between the International Airport and the City Airport. This decision rested primarily on which airport the airline believed would help it to attract the most passengers paying the highest average fares. If there were already an existing airline flying the route it intended to serve, then it would take account of the airport this competitor was using. This could influence the decision either way-it might choose to fly from the other airport in order to differentiate itself, or from the same airport in order to benefit from the high joint-frequency offered. The outcome might rest on the relative size of the operations. If it had an existing operation at either airport, it might well decide to operate its new route from the same airport, as there were economies of scale and scope in using only one airport. It would also consider which airport it believed the majority of its potential passengers would prefer as a destination (for example, for locational or interlining reasons). Airport charges and quality of airport services had little or no impact on this decision.

6.23. For example, suppose JEA were to consider moving a 96-seater BAe 146 flight from the City to the International Airport. If the International Airport were to offer airport charges at half the City Airport's published charges, this would save some £385 per flight for an average load factor of 77 per cent. However, if as a result of the move two business passengers per flight were lost, revenue loss would be £420, or £35 more than the saving. BIA submitted that, given that there were costs in changing to the International Airport, that JEA might no longer differentiate itself, that it would face direct competition from the BA and BM flights to Heathrow, and that its time-sensitive business passengers would face a 20-minute longer journey to and from Belfast city centre, it could be seen that even such a substantial airport charge advantage was unlikely to be material in enticing JEA to alter its choice of airport. BIA said that it was probably for reasons such as these that no airline had changed airport in Belfast once it had established itself. BIA drew our attention to a letter published in the *The Economist* of 23-29 September 1995, stating that reductions in airport charges had not induced airlines to move from Heathrow to Gatwick.

6.24. BIA submitted that this conclusion-that there was no effective competition between the International Airport and the City Airport-would run counter to the intuition of any observers who did not examine the industry economics in detail. Indeed, until about March 1995 BIA had itself operated under the false impression that the two airports actively competed with each other, and had based its marketing strategy on this premise. However, it had become increasingly apparent in its negotiations with airlines that there was nothing BIA management could do in terms of price and quality offered to persuade airlines to choose the International Airport as opposed to the City Airport.

6.25. It gave us a number of instances where it had negotiated with airlines but failed to influence their decisions. In August 1993 BA had complained of losses on its London to International Airport route. BIA offered a package reducing BA's charges by 50 per cent. BA subsequently said that this reduction was inadequate and threatened to move to the City Airport. In the event, no discount was made but BA did not move. Since November 1993 and during 1994 BIA had sought to lure JEA to the International Airport by offering a package involving zero charges in the first few months and very low charges beyond, together with a dedicated JEA terminal. However, JEA could not be persuaded to move. BIA believed that was because a move would involve JEA giving up its niche market position and competing head to head with BA and BM. BIA pointed out that JEA acknowledged this in its submission (which had been summarized in *The Irish News* in August 1995). In January 1995 AB decided to come to the International Airport and revealed that it made this decision without knowledge of BIA's charges. In March 1995 Gill would not accept advantageous terms to move to BIA, and later revealed that an £80,000 annual saving (in lower charges) was outweighed by its need to continue to fly from the City Airport to protect its market. BIA told us that in November 1995 JEA had sought a meeting to discuss starting services to Stansted and Gatwick from the International Airport, in order to complete with AB. JEA had not been influenced by any action of the airport.

6.26. BIA told us that this did not imply that there was never competition between airports in general. They did compete, but not for the sort of traffic where there was an overlap between the International Airport and the City Airport. For example, international passengers, particularly in the charter market, were relatively time-insensitive and thus willing to travel long distances to access charter flights. Airlines were therefore concerned to ensure the best deal possible in airport charges in order to be able to offer competitive prices. These passengers also spent more time in the terminal buildings and were therefore more sensitive to the quality of facilities than domestic passengers. In addition, once an airline had established a route its marginal decision on the frequency to operate was likely to be more sensitive to changes in airport charges.

6.27. Similar considerations applied to the notion that airports could compete for passengers. First, for 17 of the 23 routes in Belfast the passenger did not have a choice of airport. Where passengers did have a choice their decisions were heavily influenced by which airport offered the fastest access time and which airlines offered the most frequent service. Theoretically, if a passenger were indifferent between the two airports on these grounds the air fare would then become the deciding factor. However, BIA told us that an airport's ability to influence air fares was by no means certain. There was no guarantee that a reduction in airport charges would be passed on and not simply pocketed by the airline. Furthermore, that reduction would be for all passengers. This was the bottom line: a £5 reduction in airport charges per passenger would reduce aeronautical revenue at the International Airport by 50 per cent and would achieve at best a 2 to 3 per cent reduction in air fares (if passed through by airlines) which would be highly unlikely to influence any passengers' decisions at all.

6.28. BIA further illustrated the lack of competition for passengers by referring to the example of London, the most important destination from Belfast. Passengers flying to London had a choice of service: BA/BM to Heathrow from the International Airport and JEA to Gatwick from the City Airport. However, these services were differentiated to the extent that one was not a direct substitute for the other. JEA had stated that it valued its position at the City Airport because this gave it a unique selling point which differentiated it from BA/BM. Similar sentiments had also been expressed by Gill and Manx.

Charging

6.29. We put to BIA evidence we had received from the airlines that airport charges were a significant proportion of direct operating costs and a source of major concern to them. BIA acknowledged that in terms of variable costs airport charges would be relatively important, but said that it was the proportion of charges in total revenue that was the crucial relationship to consider. In relation to airline concern over charges this was entirely to be expected as any savings they could achieve in this area would go direct to the bottom line. The fact remained, however, that there was no constraint on charges at the International Airport resulting from the existence of an independently-owned City Airport.

6.30. We put it to BIA that the fact that it offered discounts, particularly for new services, indicated that it did use charges to try and influence airline choice between the International Airport and the City Airport. BIA told us that this was not why it offered discounts. These were offered because, first, it took time for traffic to build up even if the market was there, so lower charges at the outset enabled airlines to offer discounts etc to publicize services. Also the airport showed good faith and acted in partnership with the airline in absorbing the poor early months. Furthermore discounts were a significant factor in the charter market where there was real competition. Finally discounts were custom and practice in the industry. High published charges meant that everyone felt good about achieving a discount.

Further considerations on competition

6.31. BIA had commissioned research into situations where two or more independently-owned airports served the same city. This found that world-wide there were only 23 metropolitan areas (including Belfast) which had more than one airport with significant commercial passenger traffic. Most of these served extremely highly-populated cities-London, Los Angeles, New York, Paris, Tokyo etc-with populations of at least 2 million people. There were only four cities world-wide where a metropolitan area with a population of less than 1 million was served by two airports-Belfast, Edmonton, Oslo and Reykjavik. Of these, only at Belfast and Edmonton were the two airports independently owned. Indeed, world-wide the researchers found only ten cities with at least two independently-owned airports (including Belfast and Edmonton). The other eight were all extremely highly-populated metropolitan areas. Thus Edmonton, with a population more than twice that of Belfast, provided the only other example in the world where a relatively small city was served by two independently-owned airports. The reason it was so unusual to find this situation was that the economics of airport provision meant that there were no competition benefits of having separately-owned airports to offset the disbenefits associated with the implied losses of economies of scale, user density and critical mass. Indeed, in Edmonton passengers had to go to Calgary (171 miles to the South) for most connections to international flights. Consequently there had been a referendum in Edmonton which decided that the smaller municipal airport should be closed to allow the benefit of concentration of services at the international airport to be accessed. This left Belfast as the only small city in the world served by two independently-owned airports. If competition were of value it would have been expected that other cities would have followed this route.

6.32. BIA emphasized that in presenting this research it did not intend to indicate a desire to close the City Airport should it be successful in acquiring it. BIA recognized that the City Airport was valued by customers and for this reason, if the merger were successful, it would keep it open. However, BIA considered it important that it should be recognized that the emergence of the City Airport had had both positive and detrimental effects. BIA felt that joint ownership provided significant opportunities to grow the international business, allowing Belfast to achieve the best of both worlds.

6.33. BIA believed there was already sufficient control over its prices. There were very strong downward forces on prices at the City Airport, as indeed there were at most airports. The airlines produced the right pressure on the airports, and in the case of the charter market, the International Airport had to have an eye to Dublin Airport. Regulation would only be a cosmetic addition.

6.34. In response to our putting the airlines' views to BIA, it said that most of these comments were associated with a misplaced suspicion that the City Airport would be closed down. In addition, BIA felt it would be possible for airlines to come to an erroneous conclusion on whether airports competed; and even if they did agree with BIA's view that there was no competition they might not express this now. Even if they believed they would not be disadvantaged by the merger, they might have felt it more cautious to avoid the possibility of loss by arguing against it on the erroneous assumption that there was no apparent up-side in arguing for it.

6.35. At our request BIA provided a copy of its Management Buy-Out Memorandum produced in July 1994 which contained a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis; and extracts from minutes of Board meetings relevant to the merger in contemplation. These showed that over the past year BIA had been concerned about competition from the City Airport. Details are given in Appendix 6.1. We asked BIA about these documents, particularly about an entry dated 27 March 1995 which read: `It was agreed that efforts should be directed towards ensuring the relocation of Jersey European whilst ensuring that the current airlines at BIA did not become disillusioned'. We also asked about an article in *The Irish Times* of 22 March 1995 which said, `BIA stated at the time that if it did not succeed in buying the City Airport, it would continue to compete aggressively with it'. BIA said that the *Irish Times* reference was to a discussion held with a journalist towards the end of February or the beginning of March 1995, and that BIA's realization that the two Belfast airports were not in competition occurred from March 1995 onwards. We also asked BIA about its opposition to the City Airport at the 1990 planning inquiry and its opposition in 1992 to Manx's application to run a Heathrow route from the City Airport. BIA responded that these instances were entirely consistent with its analysis of the market. Naturally BIA would oppose any expansion of an independent City Airport, as expansion would allow the City Airport to take incremental traffic away from the International Airport. It had been frustrating to BIA management all the more as it could not influence airline choice. Given that BIA could not compete in a conventional manner (ie on price and quality), it therefore opposed the e-xpansion of the City Airport as this was the only form competition could take.

6.36. We asked BIA about BCA's complaint in 1994 to the Advertising Standards Authority against adve-rtisements for the International Airport which appeared to denigrate the City Airport.[1] BIA said that at that time it did not fully appreciate the economics of airline choice and thought it could influence the decisions of operators and passengers with the advertising campaign. However, the campaign was also aimed at a second audience, BIA's staff, whose morale was declining as frustration grew over the success of the City Airport. It boosted morale to see that management was prepared to fight back against the City Airport.

Consequences of the proposed merger

Likelihood of competition from another airport operator

6.37. BIA thought it was extremely unlikely that another airport operator would enter the Belfast market in future. Airports were very expensive to build and there were very few examples of new entrants to the market anywhere. The size of the population in Northern Ireland would not encourage an operator to spend the kind of money that would be needed to set up an airport.

6.38. In answer to a query about concern from the City of Derry Airport lest the JEA services between Belfast City and City of Derry were discontinued as a result of the proposed merger, BIA said that it was the airline which decided to run the route. BIA had talked to JEA since JEA had made its submission to the MMC, and had said that it would maintain and keep open the City Airport, and that JEA's relationship with BIA would continue as it had done with the previous owner. BIA said that it had also talked to BA, which had expressed concern that charges might rise. This concern seemed groundless, because charges at the International Airport had been level for three years.

Effect on employment opportunities

6.39. There would be some staff savings if the merger went ahead. BIA also said that common ownership of the two airports offered the only basis for ensuring that the jobs of present City Airport employees were preserved. If an individual owner were to come in as the City Airport operator, there would be more likelihood of a cut-back and trimming of operations. The City Airport was unlikely to be cost-effective for a stand-alone operator, given that there was such a substantial amount of work to be done there.

Possible benefits of the merger

6.40. BIA told us that synergies and cost savings would result from the merger. BIA's intention following any merger was to operate both airports as an integrated transport system and thereby enable the province to best achieve the desirable but challenging transport policy objectives outlined in the Belfast Harbour Local Plan 1990-2005. The merger would enable both airports to operate at lower levels of cost and higher levels of efficiency than was currently the case. A tier of administration would be eliminated, overheads would be reduced and significant economies would be effected-mainly in ATC, radar control and security. The calculation of costs in relation to ATC was very complex, but theoretically savings could be achieved by co-operation between the two airports even if they remained in separate ownership. Significant benefits to the environment by running the two airports as a common enterprise would also accrue. The merger would also enable the City Airport to abandon what BIA believed to be a costly but necessary requirement for any stand-alone operator to expand the City Airport, both in physical terms and the number of ATMs a year. Accordingly the adverse effects on the environment of actions such as extended opening hours and larger aircraft to be taken by such an investor to meet its investment and debt services obligations would also be avoided.

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[1]The advertisements included the claims that `one airport treats business travellers better'; `The latest technology keeps us open and operating, despite what the elements throw at us. Unlike another airport we could mention'; and `Alternatively, choose the airport with 5,000 parking spaces'.

Possible remedies

6.41. We discussed with BIA possible remedies, in the hypothetical event of the MMC's finding that the proposed merger would be contrary to the public interest. We asked whether it would be reasonable to seek an undertaking from BIA to submit to price controls. BIA said it did not consider that pressure on its charges would be changed as a result of the merger and that Belfast should not be treated differently from other UK regional airports. The CAA had quite considerable powers. Asked about an undertaking to continue to permit airlines currently using the City Airport to continue to do so, BIA said it would guarantee that, but it could not guarantee to do so on comparable terms and conditions, because it did not know the terms and conditions at the City Airport. With regard to a possible undertaking to continue to maintain existing opening hours at the City Airport, BIA said that this would present no difficulty. As to the honouring of existing incentive and market deals, BIA said that it did not know what these were. As to a possible requirement that a merged enterprise should operate the City Airport under a public use licence, BIA said that it would be happy to look at that. With regard to designation, BIA's position was that it believed the regulatory powers which would come into effect in the future would be adequate as they were elsewhere in the UK. Designation was an issue for the authorities, but BIA's understanding was that this was only employed at the major international airports (BAA's airports in the South-East-Heathrow, Gatwick and Stansted-and Manchester). As for a requirement to honour any agreements with the MoD, this could not be considered until BIA knew what agreements the MoD had with BCA.

6.42. In further discussion, BIA said that there were constraints on charges. It had in mind reviews by the British Air Transport Association and guidelines from the International Air Transport Association. The CAA also had to give permission to levy or change charges. It would be prepared, subject to due diligence, to undertake to maintain BCA's present charging structure. BIA believed it was in its interests to keep both airports open, because if the City Airport were run down, not all its traffic would move to the International Airport (in other words, some traffic would be lost). BIA made it clear that in so far as it would keep the City Airport open, it had to be on the basis that BIA could make a reasonable rate of return on it. However, it noted that an airport such as the City Airport with a passenger volume in excess of a million should be profitable.

6.43. BIA provided us with developed proposals in the event of its acquiring BCA. These are set out below:

> These proposals of BIAL have been developed by BIAL to provide comfort to current users of Belfast City Airport (BCA) in the event that BIAL or any of its associate companies has control of, or acquires a controlling interest in, BCA.
>
> The proposals have been developed on condition that the airport charges at BCA do provide for a reasonable rate of return on assets.
>
> On this basis, BIAL is willing to undertake as follows:
>
> 1. To keep BCA open during its current permitted operating hours for commercial air transport services;
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> 2. To honour existing contractual arrangements between BCA and its airport users as to the levy of airport charges. BIAL is currently unaware of such contractual arrangements and this undertaking is given subject to the completion of due diligence;
>
> 3. To ensure that airport charges at BCA are just and reasonable, not discriminatory, are based upon sound economic principles and on generally accepted accounting practices within the United Kingdom;
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> 4. To carry out such maintenance and repair work to the runway, apron and taxi-way at BCA as may be required from time to time by the Civil Aviation Authority's airport licensing requirements;
>
> 5. To apply for a Public Use licence for BCA if so requested by all air carriers operating from BCA;

6. Not to take any steps, or attempt to influence, the distribution of existing commercial air transport operations as between BCA and BIA;

7. Taking account of existing planning constraints and obtaining any necessary consents, to have regard to the development of air transport in Northern Ireland and to efficiency, economy and safety of operation in the provision by air carriers of commercial air transport services at BCA;

8. Taking account of such planning constraints, to allow the expansion of such services and facilities up to the reasonable capacity limit of the existing terminal building at BCA;

9. To encourage the development of new routes at both airports in order to secure additional scheduled and non-scheduled services to and from Northern Ireland, subject to the terms of any Public Use licence and to any other future regulation of airport charges; and

10. To provide adequate facilities for users of both airports for consultation with respect to matters affecting their interests.

Shorts and BCA

6.44. Shorts provided evidence jointly with BCA, which gave information on operational matters.

Background to Shorts' offer of BCA for sale

Operational considerations

6.45. Shorts stated that the initial development of the City Airport occurred because it considered that commercial operations there could make a contribution to its overheads, and be a useful marketing tool for its SD 3 series aircraft. When Shorts was acquired by Bombardier in 1989, BCA was retained despite the fact that airport management was not part of Shorts' or Bombardier's core businesses. BCA appeared to have possibilities for growth and was achieving the return on utilized assets required by the Bombardier group. Continuing capital investment was needed but Bombardier was prepared to see this made in view of the growth potential. When BIA was privatized in 1994, Shorts and Bombardier had considered whether to make airport ownership a core business and seek to buy BIA, but decided against it. It had been recognized that considerable capital investment in the City Airport would be required in the next five years or so-nearly £7 million had been considered desirable or essential by 1998 and a further £8 million had been envisaged by 2000; furthermore ERDF grants were much less readily available. It had therefore been decided that a buyer should be sought for BCA. In the event, the decision to dispose of BCA had been precipitated in March 1995 by the approach made by Sarcon to acquire BCA and the Sydenham site. After the proposed acquisition by Sarcon had fallen through in June, it had been decided that BCA should be put up for sale and BZW had been appointed to advise on the disposal.

6.46. Shorts' relationship with the BHC, who owned the land on which the airport was built and an area of 3,000 acres comprising the entire harbour area, was complex. The position on the sale was that Shorts wished to sell its lease of the City Airport and the adjacent Sydenham site, either as a package or as separate lots. Shorts told us that it would want to retain the right to use the runway. The plan was that the new owner's lease from the BHC should specify that if the runway should ever cease to be used for commercial operations, then the lease of the runway would revert back to Shorts.

6.47. In view of the current operational and planning constraints on the City Airport, Shorts was of the view that it would be difficult for any new owner to expand the airport's operations to take in additional land other than the QUAS site. The consent of the BHC would be required; but the present indications were that the BHC would prefer to see planning permission sought for retail development of the Sydenham site and the adjoining site known as D5. In the opinion of Shorts, the Sarcon bid had been essentially a potential property deal, which had fallen through when Sarcon had realized that it had not been successful in bidding for the development of the D5 site.

Financial matters

6.48. The financial background of Bombardier, Shorts and BCA is outlined in Chapter 3. Shorts told us that the BCA management accounts accurately reflected the performance of the business, but added that because BCA was a subsidiary of Shorts, certain services might well be supplied more cheaply than they could be to an independent owner. Shorts said that it would value the airport business at somewhere around the £24 million level which it had provisionally agreed with Sarcon; that had included the Sydenham site whose value could not be determined accurately prior to planning consent being obtained and negotiations taking place with the BHC.

Investment needed at the City Airport

6.49. The extent to which investment in the City Airport is needed was, in Shorts' view, as set out in Appendix 3.2. If Shorts were to continue ownership, it would want to carry out about £[*] worth of minimum improvements. The extent of investment which a new owner might judge to be required would depend on how expansionist the plans for the City Airport were and whether the necessary consents for any such expansion could be obtained.

BIA's offer

6.50. The background to BIA's offer is contained in Chapter 3. Shorts said that it believed BIA had been in negotiation with the BHC, but it did not know the outcome of those negotiations. Its view was that if it could get as good a price for the combined City Airport site and the Sydenham site as it had thought it would from Sarcon, then it would escape the diversion of being involved in the development aspects of the land. Shorts did not have a clear view of the risks involved in trying to develop the Sydenham site. It did not think BIA wanted to use the Sydenham site for airport purposes.

Markets

General

6.51. Shorts submitted that the principal market in which BCA operated was the provision of airport services to air carriers. In identifying the markets in which BCA operated, there was a danger of confusing the activities of airports with the activities of air carriers. Airports did not decide on the routes which air carriers would fly, the number of frequencies they offered or the prices they charged for their flights: these were decisions of the air carrier. The influence of the airport operators (as opposed to external factors) in such decisions was usually limited, particularly since the advent of the Third Liberalisation Package in the EC which in principle entitled any EC carrier to a route licence between any EC airports. Unless this distinction was recognized, the scope for competition between airports (as opposed to that between air carriers) was blurred and the effects on competition resulting from a merger of airports might be exaggerated. For example, competition between air carriers could and did occur even if their services were from the same airport.

6.52. At the City Airport only basic facilities were offered. The biggest advantage was location, because within the catchment area was a large part of the travelling population, particularly business travellers, who found the convenience aspect, and quickness of throughput of passengers, to their liking (it is possible for a businessman to leave his place of work in the city centre and to board his flight within half an hour). The airlines which had established themselves at the City Airport over a long period of time, for example JEA, had spent a great deal of time and effort building up their businesses there, with BCA's encouragement. BCA told us that it had not been too interested in the International Airport's business; rather it had endeavoured to ensure that its own customers were able to develop as they wished. If JEA had somehow differentiated its

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*Figure omitted. See note on page iv.

service by association with the City Airport, then it was questionable to what extent it could realistically consider switching airports.

6.53. In the case of the City Airport, there were a number of factors (physical constraints, planning constraints and property issues) which curtailed the scope of services to air carriers. In addition the nature of demand for air transport in Northern Ireland played a role. The population of Northern Ireland was only 1.6 million, and there had to date been insufficient demand for international scheduled services to introduce many viable services from any of the Northern Ireland airports. The City Airport's principal market was as set out in BCA's mission statement in its 1995 strategic plan, namely, `air transport links between Northern Ireland and Great Britain'.

6.54. BCA's 1995 strategic plan did include obtaining a London/Heathrow route by the winter season of 1996/97, but Shorts said that this was in fact unlikely to happen. In August 1993 BA had asked BCA for a proposal to accommodate its shuttle service to Heathrow and its services to Glasgow, Manchester and Birmingham, but subsequently BA had declined the proposal offered by BCA. Shorts told us that BA was not willing to make a commitment as to a time period which would allow BCA to recover the investment that would have been needed, nor was BA willing to make a contribution to that investment. The strategic plan had been drawn up at a time when BCA's policy was expansionist, and when Manx had been able to secure a few slots at Heathrow. The situation had since changed. An airline which did not already have slots at Heathrow was unlikely to obtain them.

6.55. Shorts told us that the only service which the City Airport provided directly to passengers was car-parking facilities, and that air transport services to passengers were the air carriers' market. Whilst indirectly passengers benefited from services at the airport such as check-in facilities, baggage handling and security, these were in fact services provided to, and paid for by, the air carriers. As to the running of certain routes and the frequency of flights, these were not choices of the airport but of air carriers able to provide such services. At the end of the day, passengers had to go to the airport where flights they wanted were provided by particular airlines.

Geographic market

6.56. Shorts told us that the geographic market could conveniently be defined as the catchment area for passengers. To the extent that catchment areas for particular airports overlapped, they could be said to be within the same geographic market at least for those passengers in that area. Catchment areas would, however, vary depending on the type of traveller and his or her ultimate destination. For example, the Belfast airports would have a wider catchment area for travellers wishing to go to London (where they were the only airports with a service) than they would for those wishing to go to Glasgow or Manchester (where Eglinton Airport had scheduled services). BCA did not have recent studies of respective catchment areas either of the City Airport or of the other airports in the province and in the republic. It thought the catchment area for the two Belfast airports would cover the whole of the province. Some 60 per cent of the City Airport's passengers were thought to be business people.

Market share

6.57. The market share of each of the two Belfast airports is discussed in Chapter 4.

6.58. Shorts said that both the London and the regional markets were important to BCA. The services that had been developed to the regional airports from the City Airport were a great success story. The International Airport had catered for some of these routes before the City Airport had opened up, but the smaller airlines had been happy to buy some of Shorts' aircraft and to operate from the City Airport, thus generating quite good, profitable business from an airport's point of view. London effectively was one market, and in view of the fact that acquisition of a Heathrow route was unlikely, BCA was trying to encourage the development of the Stansted and Luton routes. The main area of overlap between the City Airport and the International Airport was in flights to the five regional airports[1] which were served by both Belfast airports.

[1]These five regional airports are Birmingham, Glasgow, Leeds/Bradford, Manchester and Jersey.

The International Airport had always regarded the London operations to be more its bread and butter routes, and had wanted to safeguard those, particularly the Heathrow operations.

6.59. Shorts told us that the City Airport was scarcely in the market for charter flights or cargo flights, owing to its restricted opening hours.

Competition

Competition in the provision of airport services to air carriers

6.60. Shorts submitted that the extent to which the two Belfast airports competed, actually or potentially, in the same markets was very limited. In 1990 the DoE(NI) in the Belfast Harbour Local Plan 1990-2005 had characterized the airports as follows:

> Since the introduction of passenger services in 1983, Belfast City Airport has fulfilled a complementary role to Belfast International Airport (Aldergrove). Aldergrove is Northern Ireland's major airport-the trunk route and international gateway. Belfast City Airport operates mainly as a regional airport serving other regional centres in the United Kingdom with short haul aircraft. The Department would wish to see this complementary relationship maintained.

Shorts said that whilst BCA had successfully challenged the policy statement that its role should remain `complementary' in the context of the public inquiry into the local plan, this had been primarily to ensure that its potential for growth was not restricted. In practice, however, subsequent growth had largely been in domestic services to regional airports and certain London airports, whilst in other areas its role had remained largely complementary.

6.61. It was noteworthy that the Department of Trade and Industry press release when making the reference (1 August 1995) had stated: `The Minister considers that the proposed acquisition raises competition concerns in the provision of *scheduled domestic* flights between Belfast and other UK airports' (emphasis added by Shorts). The City Airport only had one `international' scheduled service at the time of the reference, namely the JEA service from City of Derry via the City Airport to Dublin,[1] and there was no overlap with services from the International Airport. The potential for competition on international scheduled services was very limited. Demand, aircraft range and slot availability made it unlikely that airlines would start services in competition with the already limited services from the International Airport. Against that background, Shorts submitted that any effect on competition as a result of a merger in relation to facilities for such services would be immaterial. With regard to international charter flights, only a very small number had operated from the City Airport for ski holidays between December and March. Capacity, aircraft range and operating hours combined to make it difficult for the City Airport to attract a significant level of charter services, particularly for summer holidays, so as to be able to compete with the International Airport. Shorts noted that a number of third parties concurred with its views on international traffic. With regard to freight and mail, Shorts submitted that the City Airport's operating hours and capacity constraints meant that it was unlikely to attract significant business. The City Airport had limited freight and no mail. A merger was therefore likely to have no material effect on competition.

6.62. With regard to domestic routes, both airports served (or had recently served) Stansted, Luton,[2] Birmingham, Glasgow, Jersey,[3] Leeds/Bradford and Manchester. Neither airport provided scheduled domestic flights: they provided the facilities; air carriers provided the flights. In so far as both airports were able to provide carriers with the services necessary to operate these common routes, actual competition already existed. This did not automatically mean that there was potential competition in the provision of services for the operation of any route. Whilst the establishment of a Heathrow route figured in BCA's strategic plan, a combination of factors had prevented that materializing (except for a short period in 1994) and were likely to continue to do so due to lack of slots at Heathrow.

[1]The Dublin service has since been discontinued.

[2]At the time that Shorts made its submission, it stated that Luton was served from both airports. The service from the International Airport to Luton was in fact discontinued in June 1995.

[3]Jersey is served by the International Airport only in the summer months.

6.63. BCA was providing facilities for those airlines which wanted to operate out of the City Airport, and the reasons for those airlines wanting to use that airport were that the airlines could make money there. Shorts thought the City Airport's growth in market share was likely to level off in the current year principally because of the discontinuance of a Heathrow service in 1994. Over the next few years it expected growth of between 3 and 5 per cent.

6.64. Shorts did not accept that supposed competition between the two airports had led to cheaper fares being available from the City Airport, particularly on routes with competing services. The fare structures on the domestic routes from which flights operated out of both airports were very similar particularly on mature routes where fare levels were fairly high. Nor did it accept that supposed competition had been a factor in opening up a wider choice of destinations in the UK. The 14[1] routes only served by airlines operating out of the City Airport had been created by airlines building up services from that airport, and serving a particular market; they owed nothing to competition between the airports. Shorts concluded that supposed competition between airports did not have any great significance for airline fares. It was not in the airports' gift to promote competition between the airlines.

Air carriers' choice of airports

6.65. There were limits on airport interchangeability for carriers. Even if airports could in theory compete for the business of particular airlines, airlines might have good reasons for not availing themselves of that possibility: namely, increased costs if they split services; loss of any advantage gained in differentiating their service by association with a particular airport; loss of passengers if brought into more direct competition with other airlines; and the risk that another airline would profit from goodwill built up at the current airport. A particular air carrier might to some extent be `captive' to a particular airport. Shorts considered that this had been borne out by the airlines' comments on competition. This was particularly relevant to the City Airport where two carriers (Manx and JEA) accounted for over 90 per cent of passenger throughput in 1994. In so far as a carrier was `captive' to either airport, the effect of a merger on competition would be correspondingly muted because only limited interchangeability existed before a merger.

6.66. Shorts told us that it and BCA wished to make sure that the customers at the City Airport could expand and grow their businesses as they wanted to do. Passengers could choose an airport for convenience of location, but the services and facilities that were provided by the airport were provided primarily to the airlines. Shorts said that it could be argued that by operating out of different airports, airlines were shying away from competition that they would have had to face if they had tried to compete from the same airport.

6.67. Shorts said that some people would prefer one airport rather than the other purely on grounds of location. This was not really competition as such. It was just a fact of having an airport in the centre of Belfast that attracted people by its convenience. Potential competition would be limited in the future whether the merger took place or not. The City Airport could not realistically expand beyond a throughput of about 1.7 million passengers under existing capacity and planning constraints; and thus, in the absence of major investment and success in obtaining the necessary consents, any overflow was likely to go to the International Airport.

6.68. The prospect of either BA or BM transferring to the City Airport appeared remote in the light of the outcome of discussions with BA in 1994 and planning constraints. Equally, JEA had built up a profitable business at the City Airport over the years and therefore if it were to move to the International Airport it would almost certainly lose business. Gill had refused an attractive package from BIA, it appeared, for similar reasons. If there was any genuine concern by incumbent airlines or potential new entrants about being forced to a particular airport, Shorts maintained that this could be resolved by the City Airport being operated under a public use licence which, subject to capacity limitations, would entitle an airline to choose the airport it wished to use.

[1]These 14 routes were Gatwick, Aberdeen, Blackpool, Bristol, Cardiff, Edinburgh, Exeter, Guernsey via Gatwick, Isle of Man, Liverpool, Londonderry, Newcastle, Prestwick and Southampton.

Charging

6.69. Airport charges are discussed in Chapter 4. Shorts submitted that it was difficult to see how the proposed merger was likely to bring about a greater freedom to raise charges. Any airport wanted to maximize its returns and its revenue but the scope for increases in charges would be limited because consequent price increases by airlines would result in reductions in passenger numbers. A proper balance had to be struck between charges and passenger numbers. Shorts submitted that this would be the case even if the airports were under common control. It would not be in BIA's commercial interest to take any steps which might reduce the significant growth in passenger numbers to and from Northern Ireland since 1992. Shorts also submitted that, in view of the strong (in some cases compelling) reasons for many airlines to remain at their current airport, the existence of two airports under separate control was not a significant factor in keeping airport charges down. The CAA also had considerable regulatory powers to prevent overcharging and discriminatory charging, under Part IV of the Airports (Northern Ireland) Order 1994, which had recently been brought into force. The City Airport's charges varied between 10 and 20 per cent of the full fare to UK mainland destinations on mature routes. The main attraction that the City Airport had for airlines was its location. BCA's policy was to assist airlines as they started up new routes, but as the passenger numbers grew, the airport would expect a greater contribution from the airline.

6.70. Shorts acknowledged that regulatory constraints were not the ideal method of controlling charges and prices, but maintained that the CAA's powers under the Airports (Northern Ireland) Order were a perfectly efficient safeguard in circumstances where it was in BIA's interests to charge so as to maximize passenger numbers. It was important for airports to work closely with their customers. BIA now realized that and was unlikely to handle the merged enterprise very differently from the way BCA had handled the City Airport. It would not be in BIA's commercial interest to interfere with the commercial success of the City Airport-based airlines or to discourage them from starting new routes which might increase overall traffic. BIA had stated that it would maintain current operations at the City Airport. Shorts said that it was not privy to the financial situation of BIA, but it thought the value of the Sydenham site, if purchased, might well offset the cost of any capital investment BIA might need to make at the City Airport. Shorts expected BIA to pitch any bid at a level which would enable it to make a return on its investment at the City Airport but at the same time not incur heavy capital expenditure. It did not accept that BIA's original offer must be predicated on the extraction of monopoly profits.

6.71. At our request, Shorts provided a copy of BCA's 1995 strategic plan for 1995/96 to 1999/2000. This showed that Shorts had been concerned about competition from the privatized International Airport. Details are given in Appendix 6.1. We asked Shorts about this and about its complaint in 1994 to the Advertising Standards Authority about the advertisements mentioned in paragraph 6.26. Shorts said that it had made the complaint in response to an insulting series of advertisements which were denigrating the City Airport. As for the competition point, Shorts said that when it had talked about competition, it had been talking about trying to ensure that the airlines operating at the City Airport were able to develop their business. The five-year plan had been drawn up at the time that BIA had just been privatized, when the new BIA management was plainly more active than the old and BCA was concerned that its airlines might be lured to the International Airport. In fact, it was now evident that the BCA airlines were not willing to move. Nevertheless, BCA had had to be alert to the possibility of passengers switching to competing services from the International Airport unless facilities at the City Airport were improved.

Consequences of the proposed merger

BIA's long-term intentions

6.72. Shorts said that in its opinion BIA would not be in a position to force any of the current City Airport airlines to move their operations. If any new operators appeared, then it was possible that an owner of a merged enterprise might be able to direct them to the International Airport, but not if BCA was operated under a public use licence and it still had spare capacity (there was currently headroom for at least 250,000 extra passengers and with certain alterations up to 500,000). BIA had a distinct benefit as a bidder in that it would have flexibility as to what capital investment to make in the City Airport, given its spare capacity at the International Airport, whereas any other bidder would effectively have to grow the City Airport to maximum capacity and was likely to have to expend more in terms of capital expenditure. If a major expansion of the

City Airport was undertaken (a new terminal, new car park, new runway and taxiway), the major capital investment involved would almost certainly have to be recouped in higher charges.

Likelihood of competition from another airport operator

6.73. Shorts explained that the possibility of disused airfields in Northern Ireland being developed or a new airport being built in the south of the province was remote given current demand. Indeed Belfast was the only UK city other than London with two commercial airports. Approximately 60 per cent of business travellers were thought to reside in and around Belfast. Nonetheless it should be noted that some £8.9 million (of which 75 per cent had been funded by ERDF grants) had been invested in the last two years in developing the facilities (in particular by constructing a new terminal) at City of Derry Airport where passenger numbers had increased from around 25,000 in 1992 to over 30,000 in 1994. In practice, the level of commercial operations at the City of Derry Airport was very small.

6.74. When asked to comment on concern that the services from the City of Derry Airport to the City Airport operated by JEA might be discontinued as a result of the proposed merger, Shorts replied that any decision to continue or not continue the service would be a matter for the airline operating the service. That particular route, from City of Derry Airport to City Airport to Dublin,[1] was still in a fairly embryonic stage. Usually a period of 12 months was needed before an airline could judge whether a satisfactory passenger load factor was being built up. Shorts saw no reason why the City of Derry service should be discouraged if the merger went ahead if it had the effect of increasing passenger throughput and airport revenues.

6.75. Shorts pointed out that if, hypothetically, commercial operations in the future ceased at the City Airport with the result that the runway was used only by Shorts' aircraft, Shorts could reopen it again. The cost of keeping the runway merely for the few flights needed for manufacturing would be too high. In view of the MMC's concern about the question of the possible reversion of the runway site and Shorts' ability to recommence commercial operations, Shorts gave the following assurance to the MMC:

> Shorts undertakes that, in the event that the assets and liabilities constituting the business of Belfast City Airport (BCA) are purchased by Belfast International Airport Limited (or any of its associated companies) (BIAL):
>
> (i) Shorts will use its reasonable endeavours to secure that the arrangements for such sale will provide that, if commercial air transport operations from BCA have been discontinued for any reason and the Belfast Harbour Commissioners are unable to find an alternative operator for BCA, a new lease of the Runway Site will be offered to Shorts; and
>
> (ii) Shorts will ensure that, in the event that Shorts is offered such a new lease of the Runway Site, it will be under no contractual restriction in favour of BIAL not to recommence commercial airport operations on the Runway Site.

Effect on employment opportunities

6.76. Shorts told us that, if BCA continued under Shorts' ownership, it would not anticipate any significant changes in overall employment levels. [

Details omitted. See note on page iv.

] The situation on an acquisition by BIA was unlikely to be markedly different because, in relation to most ancillary services, staff levels were directly proportionate to the throughput in passengers. BIA might be able to achieve greater rationalization of management staff in so far as there was duplication with activities at the International Airport. It should be borne in mind, however, that BIA ownership was likely to increase opportunities for employment, if it purchased and developed the Sydenham site, both in terms of construction workers and subsequently retail staff. In addition, it should be noted that when Bombardier acquired Shorts from the UK Government in 1989, it agreed that if it sold BCA at any time between four and ten years following completion of the Shorts acquisition, it would enter into binding commitments within the three years following to apply the net sale proceeds in certain forms of qualifying expenditure. Such qualifying expenditure comprised investment in capital equipment in Northern Ireland, research and development in Northern Ireland or training of personnel

[1]The Dublin service has now been discontinued.

based there or non-recurring costs of aerospace programmes related to group businesses in Northern Ireland. If Bombardier failed so to apply the net sale proceeds, it must pay the excess of the net sale proceeds over qualifying expenditure to the Government. In summary, these were provisions to ensure that the sale of BCA did not have an adverse impact on capital investment and employment in Northern Ireland.

6.77. Shorts told us that in any event it would seek to introduce further economies into the operational cost side of BCA, [*Details omitted. See note on page iv.*] In a merged situation, there would almost certainly be some rationalization. [*Details omitted. See note on page iv.*]

Possible benefits of the merger

6.78. Shorts submitted that, given that it had taken the strategic decision to sell BCA, the benefits that might result from this sale must be assessed in relative terms; that is, it was necessary to compare the benefits which might flow from a sale to BIA with the benefits which might result from the sale of BCA to an alternative purchaser. The public interest in the case of the proposed sale of BCA must be to aim to achieve an efficient allocation of resources for the provision of airport services in Northern Ireland. Although the promotion of competition was one means of achieving such an efficient allocation of resources, this should be regarded as a means to that end, not simply an end in itself.

6.79. Shorts told us that it was not privy to BIA's detailed plans for BCA in the event that BIA acquired it or the commercial rationale for such plans, but was merely aware of BIA's public statements. Nonetheless, BIA as an existing airport operator in the province clearly had more options for optimizing the allocation of airport resources in Northern Ireland than an alternative purchaser would have. In Shorts' view, it was possible to compare three hypothetical scenarios. The first was that BIA might purchase the whole site. BIA had indicated that if it acquired BCA it would operate the airport broadly at current levels rather than seeking to expand its capacity. This would enable it to dispose of the entirety of the Sydenham site for retail development purposes. Shorts estimated that the value of the entire Sydenham site, 33.75 acres, with planning permission for retail development could be in excess of £13.5 million. The BHC would clearly want to recoup some of that value as the price for its consent to development, but BIA would presumably be able to reduce its cost burden substantially on this scenario.

6.80. The second scenario envisaged by Shorts was the purchase of the whole site by another purchaser (not an airport operator in Northern Ireland) who intended no expansion of the City Airport. This scenario would be very much the same as the BIA scenario.

6.81. The third scenario envisaged by Shorts was the purchase of the whole site by a developer who planned extensive development of the airport itself. On this scenario the purchaser would seek to expand the airport substantially by using a large part of the Sydenham site. Assuming that a new terminal building, apron, embarkation facilities, taxiway and car park were built and the runway resurfaced, Shorts believed the capital investment (over and above the purchase price) could be of the order of £15 to £20 million. It would also require a substantial part of the Sydenham site (possibly up to 30 acres) which would no longer be available for disposal and redevelopment for retail use in accordance with the wishes of the BHC which would therefore require compensation.

6.82. Shorts maintained that each of these scenarios had different benefits and disadvantages in terms of the wider public interest. On balance, however, it appeared that acquisition by BIA would be the most favourable. In this case, certain synergies were likely to be available due to the fact that the purchaser was already an airport operator in Northern Ireland. These were likely to be in the areas of ATC; ramp services; catering; and administration. Under the BIA scenario, the full development potential of the D5 site and the Sydenham site was more likely to be realized, and the planning agreement constraints on the City Airport were unlikely to be disturbed, which would constitute an environmental benefit.

6.83. In Shorts' view the prudent course of action for BIA would be to maintain the City Airport at about its present level and to proceed with realizing whatever benefits it could from the arrangement it was thought by Shorts to have made with the BHC for the Sydenham site. Overall BIA would be able to develop a much more effective cost structure than currently existed for two separate organizations. It would be fundamental to the success of the whole operation that BIA would keep the City Airport essentially as it was and allow the operations there to meet their natural growth aspirations, which Shorts saw as unlikely to exceed the 1.7 million passenger movements over the next few years.

Possible remedies

6.84. We discussed with Shorts and BCA possible remedies, in the hypothetical event of the MMC's finding that the proposed merger would be contrary to the public interest. We asked whether it would be reasonable to seek an undertaking from BIA to submit to price controls. Shorts said it thought that would be most unreasonable, because such a condition would be taking away the right of BIA to negotiate its terms with the airlines. Sufficient controls would be in place, both in a regulatory sense through the CAA and from the pure commercial sense of an airport wanting to work with its customers in maximizing its passenger numbers. Asked about undertakings from BIA to continue to permit airlines currently using the City Airport to do so on comparable terms to those existing at present, Shorts said that an undertaking to continue *ad infinitum* to operate on comparable terms and conditions as now would not be workable in practical terms: it would be too difficult to monitor. With regard to a possible undertaking to continue to maintain existing opening hours at the City Airport, Shorts said that it did not think such an undertaking would be unreasonable, and it would comply with the current planning agreement. As to the possibility that a new merged enterprise might be required to operate the City Airport under a public use licence, Shorts said that it did not have any strong views about that. Some of the airlines might feel more comfortable about a merged situation if the City Airport had a public use licence. With regard to designation, Shorts thought the CAA regime afforded sufficient protection to airlines without designation. As for a requirement to honour any agreements with the MoD, Shorts said that apart from the QUAS site it had an arrangement to provide an air traffic service for military movements over the Belfast area in particular, and it could not see any reason for not continuing to provide that sort of service.

6.85. In further discussion, Shorts repeated that a public use licence might well be a safeguard if the airlines were fearful of being forced out of the City Airport to the International Airport. It would not have the legal result of requiring each airport to make the same charges for each route; but Shorts believed it would give rise to commercial pressure for such charges to be comparable. Shorts did not consider it impossible to devise an undertaking to bolster a commitment to maintain the City Airport at its present level of activity, but maintained its view that it would be unrealistic to compel BIA to continue operating on current terms and conditions. Shorts added that a prohibition of the merger would in practice have the effect of preventing the two Belfast airports merging forever, because new entry into the Northern Ireland airport market was extremely unlikely.

P H DEAN *(Chairman)*

P BRENAN

D J JENKINS

A ROBINSON

A J NIEDUSZYNSKI *(Secretary)*

1 December 1995