



Memorandum of evidence to Transport Select Committee inquiry into the future of BAA

1. Introduction

- 1.1 This evidence is submitted by Unite the Union, the UK's largest trade union with 2 million members across the private and public sectors. The union's members work in a range of industries including manufacturing, financial services, print, media, construction, transport and local government, education, health and not for profit sectors. The Civil Air Transport (CAT) Trade Group of Unite, 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 and air traffic management.
- 1.2. The union's current membership in our CAT Trade Group is over 50,000, of which over 6,200 are employed within the seven BAA airports in the UK. In addition, there are some 1,200 members of the Amicus Section of Unite working in the BAA airports. Other members of Unite are working for companies who supply services in the airports, or are working directly for airline companies.
- 1.3. The union has a unique overview of the issues facing the BAA, rather than the more partial views of the company or its customers, each of whom will have their own agenda.
- 1.4. We recognise that the company is facing a number of unique challenges in addition to those faced by the aviation sector as a whole, and we welcome the Transport Committee's inquiry to find out how the company, the government and other stakeholders will respond to the current situation.

2 Ownership of the Main London Airports

- 2.1. For the CAT Section of Unite, the most serious challenge is the perennial competition issues in regard to BAA, which is its ownership of the three main London airports.
- 2.2 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 comment was also made about BAAs Scottish Airports in paragraph 9.11.

- 2.3 Both 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 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.
- 2.4 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.
- 2.5 More recently your own report¹ unfortunately stated that: ‘we see no reason to change the view of our predecessor Committees that BAA should be broken up (p53).
- 2.6 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.
- 2.7. This we think is a simplistic and naive argument.
- 2.8. 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 oligopoly for airports serving London, it does not have a wider monopoly and it is not the most expensive of the four FLAP² airports.
- 2.9. 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 aviation lobbying group, has said that Heathrow would be overtaken by Munich by the number of

¹ Passengers’ Experiences of Air Travel Eighth Report of Session 2006–07 Volume I Report, together with formal minutes

² The FLAP airports are: Frankfurt; London; Amsterdam; and Paris

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.

| Airport | Index | Ranking |
|---------------------|--------------|----------------|
| Paris – CDG | 77 | 7 |
| Frankfurt | 72 | 9 |
| Amsterdam | 69 | 12 |
| London – LHR | 58 | 27 |
| <i>London – LGW</i> | 35 | 44 |

Table 2.1 Source: TRL Airport Charges Index 2005

- 2.10 Also competition is coming from outside of Europe for example Dubai is increasing becoming a competitor to Heathrow.
- 2.11. 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 and low cost 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
- 2.12 Thirdly, those airlines 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 it has neither.
- 2.13 This is because these airports are regulated and their prices set by the Civil Aviation Authority (CAA) and the CC. 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 the CAA and its various aviations policies controls the number of airplanes using the London airports.
- 2.14. 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. Indeed, we find it 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 between these airports, and it would be difficult to see in this situation how an economic regulatory role could be maintain at its present level. Indeed, it is quite likely that airport landing charges would increase as a result of removing the regulatory environment. This was recognised by the MMC 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. Unless Gatwick becomes a hub airport or Heathrow becomes a point to point airport, it is doubtful such competition could happen. 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, i.e. 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...'

- 2.15. Another issue is that counter intuitively the BAA London Airports could be worth more individually than all three together. 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 airports selling for about 15-16 times earnings before interest depreciation and amortisation (ebitda). 'That was the level finally reached in 2006 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.
- 2.16 Even in the current global economic situation Unite believes that at this market price BAA would have little or no problems selling Gatwick Airport. Many private equity firms, infrastructure funds and other institutional investors, especially pension funds would still be interested in purchasing Gatwick.
- 2.17. Therefore the question has to be asked would breaking up these airports actually result in a misallocation of resources? This then 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.
- 2.18 Also the Committee has to recognise that due to the existence of high 'sunk costs' any airport market is unlikely to 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 already create a barrier to entry, and if the planned expansion anticipated by the Aviation White paper goes forward, even higher sunk costs will exist.
- 2.19 Another barrier to entry, which the OFT recognises is the long-term planning restriction on 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 UK's competitive position in the global economy.

- 2.20 Therefore Unite believes 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.
- 2.21 Unite believe that the existing regulatory environment creates a positive environment that it provides certainty for BAA. 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 on the capital markets and probably at a more advantageous rate.
- 2.22. 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).
- 2.23. Gross debt at 31 March 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.

3 External Pressures

- 3.1. Nobody could have failed to notice the bad publicity that BAA has received over the last 12 months or more. But many of the events which resulted in the bad publicity are outside of the control of BAA.
- 3.2 The pressures placed on security since 10 August 2006 has resulted in BAA finding it difficult and time-consuming to recruit the additional 500 or so staff it needed for its increased security responsibilities imposed on them by the Government. The criminal records, employment and counterterrorism checks take a long time, and these checks plus proficiency tests weeded out a large proportion of applicants.
- 3.3 The requirement for physical checks on a percentage of passengers meant that more female security guards were needed than before. BAA was finding it difficult to recruit them because of a lack of crèches and other family-friendly policies. There had to be security staff at work from 3 or 4 am in order to meet the business needs of the airport, which also affected recruitment as many people did not want to start so early.

- 3.4. These increased security and employment related issues have resulted in a difficult industrial relations atmosphere at some of the airports. For example the staff at Heathrow are having to work in intolerable conditions. They require plenty of drinking water in the security areas and this is not being delivered: the working areas are not sufficiently clean and the air-conditioning caused difficulties.
- 3.5. Heathrow is a difficult place to work because of the building work taking place and the pressure of the security requirements. There is increased evidence of physical and verbal abuse of staff because of the pressurised environment for passengers and the different security regimes operating in the UK from those in other countries. There are many other employment opportunities in the area around Heathrow, which made it difficult to attract people to work at the airport.
- 3.6 'For BAA, the activities that generate customer satisfaction - providing seats, enough security guards, clean toilets and travelators that work - are a cost, not a source of revenue. Profits are derived from landing charges, parking fees and selling Burberry scarves and smoked salmon. Only a basic knowledge of economics is needed to explain why there are longer queues at the X-ray machines than for the scarves and the salmon³'.
- 3.7 As this paper indicated earlier the problems at Heathrow and other BAA airports are often the result of other companies' actions. Widespread complaints about "Heathrow hassle" were fuelled by official figures released this month that rated British Airways as the worst performer among leading European airlines for both flight delays and misplaced baggage over the busy summer period.
- 3.8. According to data published by the Association of European Airlines, covering July to September this year, BA ranked 24th among the 25 airlines which disclosed statistics for the number of delayed bags per 1,000 passengers. Only TAP Air Portugal had a worse record - although several carriers, including Virgin Atlantic, BMI British Midland and Aer Lingus do not disclose baggage figures.
- 3.9. BA, whose other main airport is Gatwick, was 26th of 28 carriers for punctuality, measured by delays in flight arrivals, ahead only of Spanair and TAP.
- 3.10. Among the big European network carriers BA's punctuality performance also remains dire, with KLM ranking second, measured by delays in flight arrivals, Lufthansa sixth, Air France eighth and Iberia 15th.

³ 'Heathrow's problems result from a flawed concept' by John Kay Financial Times: June 26 2007

- 3.11. Willie Walsh, BA chief executive, has warned again that the airline's punctuality and baggage performance remained a challenge at Heathrow, where facilities were "old and over-stretched". The airport was designed for 45m passengers a year but is currently looking after 67m.
- 3.12. During the third quarter this year BA's performance was hit in particular by the temporary closure of T4 for several hours in early July 2007 as a result of a security alert, and by failures of the baggage systems resulting in severe congestion. During July the airport's operations were also hit by the severe thunderstorms and torrential rain, which caused serious flooding across southern England.
- 3.13. Users have warned that Heathrow's poor performance posed a threat to the status of London as one of the world's leading financial centres. The City of London Corporation said that the AEA figures were "disappointing", but BA was working hard to improve its baggage handling arrangements, primarily at Heathrow. "The airport is at the centre of the City's success as the world's leading international financial and business centre. Ease of access is pivotal to the City's ability to thrive," it said. "The biggest cause of BA's problems with punctuality is over-congestion at Heathrow. The City is working closely with the government, airlines and BAA to find the best solutions to this."

4 Conclusions

4.1. Unite believes that the differences in staff attitudes and morale at the different BAA airports should be attributed to the physical working conditions rather than to the local management. 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).

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