

BAA

The OFT's reference to the
Competition Commission

April 2007

OFT912

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1 EXECUTIVE SUMMARY

- 1.1 The Office of Fair Trading (OFT) has decided to make a reference to the Competition Commission (CC) under section 131 of the Enterprise Act 2002 (the Act) for an investigation into the supply of airport services by BAA within the UK.¹ This confirms the OFT's proposed decision which was published on 12 December 2006,² and on which the OFT publicly consulted.
- 1.2 The OFT has based its decision on evidence of features of the market that we suspect prevent, restrict or distort competition. In deciding to make a reference the OFT has taken account of the views expressed by respondents to the consultation, particularly in relation to the evidence and analysis set out in the proposed decision.³
- 1.3 One company, BAA,⁴ owns airports through which over 60 % of all UK air passengers travelled in 2005.⁵ It is a major company, with UK revenues⁶ of £2,275 m in 2005/06, and its activities impact on a large number of businesses and consumers. The OFT has concluded it has reasonable grounds to suspect that BAA's high regional market shares in the South East of England and Lowland Scotland, the system of economic regulation of airports, and capacity constraints combine to

¹ The full terms of reference for the CC investigation are at Annexe A.

² OFT882, UK airports: Report on the market study and proposed decision to make a market investigation reference, December 2006.

³ Strictly speaking, the OFT published a document which was both a proposed decision on reference and a report on its market study.

⁴ Throughout this document we will use the name 'BAA' to mean the body which owns and operates Heathrow, Gatwick, Stansted, Southampton, Edinburgh, Glasgow and Aberdeen airports and various associated activities. More detail is given in Chapter 2.

⁵ Source: CAA Airport Statistics.

⁶ BAA Annual report 2005/06. BAA also has overseas revenues not included in this figure.

prevent, restrict or distort competition. This view is based on our analysis of the market but is also consistent with strong expressions of concern received from interested parties (especially airlines).

- 1.4 There has been increasing competition between airlines in recent years, driven by the entry and rapid growth of low cost carriers (LCCs) whose activities were assisted by the EU's liberalisation of airspace. This competition and the development of new business models has reduced the average fare prices paid by consumers, particularly on domestic and short haul flights.
- 1.5 Airports have benefited from the rapid and ongoing expansion of the airlines, leading to greater economies of scale in certain operations, while posing challenges to expand capacity to meet demand.
- 1.6 In Lowland Scotland, BAA's ownership of Edinburgh and Glasgow airports limits competition between these two airports. There are high barriers to entry and these airports are not subject to detailed price regulation. There is one independent competitor in this region, Prestwick airport, which seems to have had some positive competitive effect on Glasgow airport. We believe there is room for competition to provide further benefits to air travellers. We consider that joint ownership of Glasgow and Edinburgh airports prevents, restricts or distorts competition.
- 1.7 In the South East of England, BAA's ownership of Heathrow, Gatwick and Stansted limits competition between airports to promote the delivery of extra capacity in a timely and cost effective manner. The overwhelming bulk of the expansion of capacity set out in the 'Future of Air Transport' would take place at BAA owned airports. BAA has made it clear that it will only deliver this capacity, subject to planning permission and continued Government support, if it is allowed an appropriate settlement at its price regulated airports (Heathrow, Gatwick and Stansted). We received a wide range of critical representations from airlines in relation to BAA's current investment plans in the South East of England.

- 1.8 None of the major airlines operating out of BAA airports in the South East of England expressed confidence in BAA's current investment plans for the South East of England.
- 1.9 We also have concerns about the impact of the current regulatory framework. In particular, BAA has an incentive to make investments justifying higher charges to airlines, without necessarily expanding capacity ('gold plating'). While the CAA has a role in approving the inclusion of investments within the regulatory asset base, it is also under a duty to promote investment. The appropriate timing and specification of investments are extremely difficult for a regulator to assess.
- 1.10 There is evidence of poor quality of service at BAA airports, particularly those in the South East of England. This low quality appears to go hand in hand with relatively high yields. The combination of low quality and high yields was raised by several respondents during the market study and in the consultation on our proposed reference decision which raises a valid question as to the benefits to consumers of the current situation.
- 1.11 We believe that enhanced competition between airports would create better incentives to ensure that expansion takes place in a timely, cost effective manner focussed clearly on the needs of airlines and the travelling public. It could also deliver lower prices and a higher quality of service.
- 1.12 In the short term, we consider that the lack of competition between BAA's airports in both the South East of England and Lowland Scotland may lead to higher charges, or higher yields, and ultimately higher costs than would be the case if these airports were owned by separate firms.
- 1.13 Finally, airport expansion and increased air traffic, give rise to both local and global environmental concerns. These are significant matters, but it is not the OFT's statutory role to examine the validity of those concerns nor to develop policies to deal with possible adverse environmental effects arising from increased air travel. We see no inherent conflict between tackling environmental problems and developing more competition in airport services.

- 1.14 We consider that there is a reasonable prospect that appropriate remedies would be available if the CC were to find an adverse effect on competition. These may take the form of requiring BAA to divest some of its airports, or recommendations regarding the regulatory system, or both.
- 1.15 We have found potential adverse effects relating to a combination of features: joint ownership (with very high regional market shares), regulation, development restrictions and capacity constraints. We have concluded that we have reasonable grounds to suspect that the above features prevent, restrict or distort competition with adverse consequences for customers and consumers using these UK airports. We recognise that our preliminary analysis has not reached firm conclusions on these matters, but consider the analysis appropriate for the first phase and look forward to the outcome of the CC's investigation of these significant issues.
- 1.16 Our report entitled *UK Airports: Report on the market study and proposed decision to make a market investigation reference* (OFT882) ('the proposed decision') can be found on the OFT web site at:
- www.offt.gov.uk/advice_and_resources/resource_base/market-studies/airports