COMPETITION COMMISSION

BAA AIRPORTS MARKET INVESTIGATION

Heathrow Airline Operators Committee: summary of hearing, 17 May 2007

1. Heathrow Airline Operators Committee (HAOC) told us that it represented the 88 airlines that operated into Heathrow. Each of the terminals at the airport had an AOC chairman and an AOC meeting, which took place monthly. There was also a monthly meeting with BAA at terminal level. The AOC chairmen for the terminals attended the AOC executive, which was the final decision-making body for all the operational aspects that the AOC was involved with. Each airline, irrespective of size, had one vote. The executive had several sub-committees, including ramp and baggage, passenger and facilitation, and security, and a few standing committees, including a rents group. As well as the formal meeting with BAA, the Chairman and General Secretary had frequent discussions with BAA senior management.

2. HAOC said that, while the 88 airlines it represented all followed their own commercial and operational ambitions, and in a lot of cases had one-to-one dialogue with BAA, there was a lot of common ground between them where they were prepared to act in consort.

Constructive engagement

3. HAOC told us that the constructive engagement process, an initiative of the CAA, had been a success, particularly in arriving at a common baggage price, check-in price and assimilated rents. The discussions about the strategic choices for the future of Heathrow had also gone well and agreement had been reached on some moves to improve the infrastructure at Terminals 3 and 4.

4. Constructive engagement had been less successful with regard to cost control. HAOC believed that BAA could do considerably more to reduce costs at Heathrow, which would result in lower costs for the airlines. Security was a specific example: BAA was paying way above the market rate for security guards working at passenger search and the control posts for flight crew and cargo. HAOC would like to see this work contracted out to independent security companies. The airlines successfully subcontracted hold baggage screening and security at more reasonable prices (around 50 to 60 per cent of what BAA was costing) and believed that BAA should do the same where it employed security staff. HAOC believed that the private security firms had lower staff turnover than BAA's security operations, even though they paid less. This was perhaps because they were recruiting staff with lower expectations, who were prepared to do a repetitive yet stressful job. HAOC recognized that BAA would need to address industrial relations issues if it wanted to bring in private firms, but pointed out that the airlines had been forced to address such issues in order to remain competitive. Information technology was another area where BAA ought to be able to make savings through contracting out or hiring when required instead of maintaining a bespoke in-house IT department.

Traffic forecasts

5. Although there was a reasonable measure of agreement in the constructive agreement process, there were outstanding items on which agreement by the end of

June seemed (as of mid-May) unlikely. One such area was traffic forecasts, where the airlines did not accept BAA's assumptions, despite extensive dialogue between the parties and their respective economists and statisticians. The dialogue had been made more difficult by BAA's delay in providing much of the information that the airlines requested. HAOC commented that BAA should be paying attention to economic cycles rather than relying on trends in passenger numbers. It recognized that there had been a recent dip in traffic but did not believe this supported BAA's conservative approach. It suggested that the dip was due to recent security and industrial relations debacles, and to one or two large airlines steering away from Heathrow in their reservation systems because they had found it a difficult hub. It believed that these were local effects that would be overcome, rather than part of longer-term trends and cycles, and that BAA's figures were incorrect. The recent decision on Open Skies would also help the market to recover quicker than might have been expected.

Competitive equivalence

6. HAOC said that by competitive equivalence it meant that there should be a common, good standard of service, infrastructure and facilities for all airlines and at all the Heathrow terminals, with the option for an airline that wanted something above the standard to pay for it directly to BAA. As things stood at present, the facilities in Terminal 3 did not compare with those in Terminal 4 and neither would match the Terminal 5 facilities, so some airlines would get more benefit and have a greater competitive advantage than others, depending on where they were sited. HAOC was not, however, pushing for differential prices between Terminals 5 and the other terminals because it believed that equivalent pricing and facilities was a better solution. It told us that British Airways, the occupant of Terminal 5, could have benefited from significantly lower baggage prices resulting from the high throughput and efficient technology of the baggage system, but it had chosen to factor the lower cost into the calculation of an average baggage price for the whole of Heathrow, thereby producing a lower price for all the airlines than would otherwise apply. The majority of the other airlines were in favour of the building of a baggage transfer tunnel between Terminals 1, 3 and 5 (T1–T4 existing and to be refurbished).

Heathrow East Terminal

7. HAOC said that it agreed in principle with BAA's investment plans for Heathrow East, but had not (as of mid-May) seen detailed costings or a cogent business case. It accepted that the investment was needed to provide better customer service and equivalence for the airlines. It had some concerns about the consultation process, as the plans seemed to change from one meeting to another and so it was difficult to get to the detail of the business case. There was a difference of opinion about the baggage system: BAA wanted to use the existing system in Terminal 1 and connect it to the new building, whereas the airlines would prefer the new terminal to be constructed with all the facilities in the right place. The various changes in the plans had all come from BAA and appeared to be driven by a desire to cut costs; for example they had twice reduced the planned size of the terminal. However, HAOC could not be certain about the motivation as BAA had not provided it with revised costings following the changes in plan. It could be said that the regulatory regime did not object to BAA building unnecessarily expensive assets, but HAOC had observed that following the change of ownership there seemed to be a downward pressure on BAA to reduce costs.

8. HAOC explained that it had consultative meetings with BAA (not specifically to do with constructive engagement) for all large projects, and was able to get feedback on

operational capacity, cost etc from various experts. A previously existing process of sign-off had fallen into disuse and HAOC had recently told BAA that they would like it to be restored. This would allow HAOC to give formal approval at different stages of a project and to sign off at the end indicating total agreement with the scope and cost.

Non-regulated charges

9. It had not advanced as far as it could in monitoring non-regulated charges, although it had made some progress. It felt that airlines were faced with some inordinate price rises that were counterintuitive to the cost base at Heathrow. Some of the rises were commodity-driven, for example by increases in the price of electricity, but it did not notice a difference in charges when prices fell again. HAOC was trying to drive towards transparency so that it could ensure that the charges to airlines reflected the cost to BAA of operating the function, without any element of profit-making. This was hard to monitor without greater transparency. HAOC had done some work to see if the airport and the major airlines could get a better price for commodities by forming a greater buying club, but had concluded that BAA's buying of commodities seemed to be relatively efficient. The concern was with the next part of the process, where there was a feeling that the airlines were being overcharged. HAOC needed to understand why charges were increasing. There was a structure and dialogue now in place for this but there was still insufficient transparency.

Service quality

10. HAOC had asked for more measures of service quality. If it were successful in this, it would like to see the amount of money at risk increased from 3 to 6 per cent and the payments made on a monthly basis. It believed that this would be a sufficient incentive to BAA to improve customer service.

11. Aside from the money at risk, HAOC's greatest priority was control post improvements. The infrastructure that an airline needed to turn around an aeroplane (catering, crew, other supplies etc), passed through the control posts, and long waits at these points could lead to flights being delayed or even cancelled.

12. As for the security queuing standard for passengers, BAA has proposed that queuing should be no more than 5 minutes for 95 per cent of the time. Although the HAOC supported an improvement in standard—they were seeking the new standard expressed as the maximum queue length over the operating day should be no more than 10 minutes, and the average queue length over the operating day should be no more than 5 minutes.

13. HAOC told us that it would also like to see improvements in pier service and did not believe that the airlines should have to pay for this again as they had already paid through the investment at Heathrow to create new assets (Terminal 5 and two satellites and Heathrow East and two satellites) and the pier structure that went with them. BAA might argue that the airlines were sometimes to blame for poor management of piers, but this would be resolved with the opening of Terminal 5, at which point the responsibility for stand planning at Terminals 1 and 4 would pass from British Airways to Heathrow Airport Ltd, which would then manage this aspect of service for all terminals except Terminal 5, where British Airways would be responsible as the sole occupant.

Market issues

14. HAOC thought that if the BAA London airports were to be separately owned, it was unlikely there would be sufficient competition between them to remove the need for regulation at Heathrow. Most airlines wanted to be at Heathrow and separate ownership was unlikely to lead to sufficient incentives for them to move. Competition between terminals could be an attractive proposition, but HAOC had some doubts about the practicalities of it at Heathrow, where the trend was for airlines to be co-located with others in the same alliance.