

BAA AIRPORTS MARKET INVESTIGATION

oneworld: summary of hearing, 5 June 2007

Background

1. **oneworld** is an alliance of ten airlines: American Airlines, British Airways, Cathay Pacific, Finnair, Iberia, JAL (Japan), LAN (Chile), Malev (Hungary), Qantas and Royal Jordanian.
2. The discussion with **oneworld** covered a wide range of BAA airport operations. Heathrow was a prime focus, but the discussion also covered Gatwick and Stansted.

Issues

3. **oneworld** described its relationship with BAA as challenging. While airlines and airport operators worked in the same industry, there were different motivations at play, and sometimes conflicting objectives and methods. **oneworld** characterized the overall LHR airlines relationship with BAA as being conducted in a climate of suspicion. **oneworld** told us that BAA involved airlines too late in important planning processes, and presented some projects such as the Heathrow East Terminal (HET), and horizontal separation of arriving and departing passengers in a Heathrow airport pier, as *faits accomplis*. **oneworld** also suggested that BAA sometimes confused consultation with endorsement, and pointed out that talking about a project with BAA did not necessarily mean airlines had given their approval.
4. In terms of BAA's approach to consultation, **oneworld** criticized the way in which BAA announced the HET proposal to airlines without consultation, despite the project having been well-developed within BAA at the time of the announcement.
5. **oneworld** also highlighted BAA's approach to engagement around its plans to segregate arriving and departing passengers at Pier 7 in Heathrow Terminal 3 (T3). **oneworld** said that BAA's work to ensure segregation in Pier 7 had been delayed, and that recently BAA presented a 'horizontal segregation' proposal as the only option for Pier 7, despite horizontal segregation having failed in an earlier trial.
6. **oneworld** told us that BAA should adopt a more meaningful and constructive approach to consultation, in which BAA involved airlines and other core airport user groups in discussions and negotiations on major projects from the initial stages of projects onwards.
7. The Ferrovial takeover of BAA in 2006 resulted in some changes in BAA's management team. **oneworld** noted that there had not been big changes since the takeover, but that some experienced staff had left BAA and the balance of skills had shifted away from airport operational knowledge, and towards retail and construction knowledge.
8. **oneworld** also cited the Buncefield incident (a major oil storage terminal fire in December 2005) as being a catalyst for disagreement with BAA. Buncefield had supplied 30 per cent of Heathrow's fuel, and the incident led to fuel rationing at the airport. BAA's fuel management proposals for Heathrow were being closely monitored by **oneworld**.

9. **oneworld** was generally positive about the policy of constructive engagement with BAA, in which the airport operator met airlines to discuss operational and planning issues. The meetings provided an opportunity for airlines to gain more information about BAA's plans. **oneworld** also viewed constructive engagement as an opportunity to press for continual service improvements from BAA. Despite the positive aspects of the constructive engagement process, **oneworld** said that BAA lacked a sufficiently competitive operating environment, which led it to neglect the customer-vendor relationship with airlines.
10. **oneworld** questioned BAA's traffic forecasts, particularly in terms of traffic movement between Heathrow, Gatwick and Stansted. It believed that BAA's overall traffic forecasts were too low.
11. When comparing Heathrow to other airports, **oneworld** observed that Heathrow was its most important airport. **oneworld** indicated that huge changes were underway in the structure and operations of the airport, which brought significant cost, disruption and uncertainty to airlines. These changes, coupled with the way in which BAA conducted its relations with airlines, led **oneworld** to observe that BAA was one of the most challenging airport operators to deal with and get decisions from.
12. In discussing airlines' responses to industry shocks such as 11 September 2001 and the SARS epidemic, **oneworld** told us that such crises affected airlines more severely than airports. The risk associated with such crises was greater for airlines because of the fierce competition for a smaller pool of potential passengers in such circumstances.
13. **oneworld** indicated that alliance co-location was a key focus for its operations, to facilitate easier connections between services. Heathrow was a particular focus for these efforts, as it was a major hub for transfer passengers.
14. **oneworld** said that the new Heathrow Terminal 5 (T5), which would be wholly occupied by **oneworld** member British Airways, would be a positive development for all concerned. T5 would help to improve the effectiveness of passenger, baggage and cargo connections, but one by-product would be that **oneworld** would be the only airline alliance with airlines operating from more than one Heathrow terminal.
15. **oneworld** said that one problem that had arisen was the delay in moving SAS and Air Canada out of T3, because of BAA's inability to provide sufficient on-pier service¹ at replacement facilities. The delays would affect planning for a new baggage handling system, and some work would be shifted from Q5 to Q6. **oneworld** found out about the delays only recently, despite the problem having been identified by BAA for some time.
16. **oneworld** also said that it had been pushing BAA to revise its initial plans for T3 refurbishment, because the proposed timeframes were too long. As an example, **oneworld** told us that BAA's initial proposals involved refurbishment in Q6. **oneworld** said that airlines told BAA that this timetable was both inadequate and outside the memorandum of understanding signed by BAA. **oneworld** expressed strong concerns that refurbishing T3 was a lower priority for BAA than HET, thereby resulting in the T3 airlines being in a disadvantageous position at Heathrow. **oneworld** saw the refurbishment of T3 to be competitively equivalent with other Heathrow terminals as an important necessity to be undertaken sooner than BAA planned.

¹On-pier service involves aircraft being connected to airport departure and arrival lounges via air-bridges rather than buses or walking across the tarmac.

17. **oneworld** said that airport charges were one of the main cost drivers for airlines. Value for money was a key objective when judging the fairness of charges, as airlines could find it difficult to pass on increases in airport charges directly to customers. The constructive engagement process with BAA allowed airlines to have some input and debate on airport charging. **oneworld** would prefer airport charge decisions to be more transparent, particularly as regards the BAA decision-making process. **oneworld** said it would welcome the opportunity to learn how BAA arrived at its pricing for airport charges and what the perceived commercial benefits of its various investments were, so it could make up its own mind about the merits of BAA spending plans.
18. In discussing BAA's cost of capital, **oneworld** said that it encouraged BAA to look at cheaper construction methods to reduce costs. Examples provided included planning for shorter construction periods so as to reduce overall project cost inflation, and spreading project risk allocations over a wider range of projects. **oneworld** argued that well-designed lower-cost terminals could still be profitable and provide a high-quality passenger experience. At present Heathrow was a high-cost airport that ranked 80th out of 94 airports in a recent international survey of passenger experience.
19. **oneworld** cited the example of Zurich airport as a good example of a more streamlined and cost-effective model for airport construction projects. **oneworld** said that the methods adopted at Zurich resulted in quicker construction and lower overall costs and risks.
20. In terms of BAA's operating expenditure, **oneworld** told us that it was hard to find out the details, and BAA's position could often change from one meeting to the next. BAA's expenditure on security services and information technology should be made more efficient, particularly through outsourcing. **oneworld** also said that BAA made a lot of decisions that reflected its desire to increase the Regulatory Asset Base rather than deliver a service.
21. One of BAA's plans was to set a service standard for airport security, with 95 per cent of passengers waiting no longer than five minutes to be processed by security staff. **oneworld** told us that inflexible security staff rostering was a key factor limiting the reduction of security queuing. It would welcome the opportunity to see a cost and capital breakdown for the '95-5' initiative, and it recommended that methods of counting queue duration should be improved.
22. **oneworld** identified what it characterized as considerable benefits that could be derived from outsourcing some services in BAA's airports. **oneworld** argued that outsourcing was a common practice in other jurisdictions, and could provide reliable services at lower cost than in-house options. One example cited was outsourcing security post checking. **oneworld** believed that the relationship between BAA and the Transport & General Workers' Union (T&GWU), the union representing BAA security staff, was not effective in keeping costs down and achieving efficient passenger processing. Part of the problem, **oneworld** told us, was that the current start and finish times for airport security employees often failed to take account of the peak periods of passenger processing, such as the early morning.
23. This differed from arrangements in the USA, where airport security services were unified under a single government agency in response to the heightened state of alert following 11 September 2001. **oneworld** told us that after initial teething troubles, the US security apparatus had succeeded in creating an efficient security process. However, **oneworld** believed that in the UK outsourcing could be beneficial.

24. **oneworld** told us that BAA's approach to information technology issues could be improved. **oneworld** said that BAA involved airlines in IT planning far too late in the process, so their views and requirements were often not adequately captured or reflected. **oneworld** also said that BAA's policy of managing IT projects and systems in-house, rather than outsourcing to external providers, was leading to higher costs.
25. The Civil Aviation Authority had proposed efficiency targets for BAA of a 1 per cent reduction in costs per year. **oneworld** said that this target was insufficient, and claimed that, unlike airlines, BAA did not have a survival motivation. A BAA efficiency target of cost cutting of perhaps 5 or 10 per cent would be more appropriate, and in line with the levels of efficiency sought in airlines' own internal cost-cutting reviews. **oneworld** also said that other airports worked harder than BAA to cut their costs. In terms of priorities for efficiency gains, **oneworld** identified security services and baggage handling as prime targets.
26. In July 2003 a BAA Service Quality Rebate (SQR) scheme had been announced. **oneworld** was reasonably content with the development of the SQR since the last Competition Commission (CC) report, but thought the risk settings should not be set too low, as BAA needed a stronger incentive to achieve higher performance standards.
27. Responding to the CC's questions about joint ownership of airports, **oneworld** said that BAA's ownership of Heathrow, Gatwick and Stansted generated a less competitive commercial environment in the London aviation market. **oneworld** argued that separately-owned airports would:
- compete more vigorously for airlines;
 - have greater incentives to improve airport infrastructure;
 - be more likely to push for extra runways (a second runway at Gatwick, and a third runway at Heathrow); and
 - be unable to cross-subsidize inefficient practices at other airports.
28. When asked about separate ownership of the terminals at New York JFK airport, **oneworld** said that this situation was probably unique, and most likely not replicable in London because of capacity constraints, different land ownership and easier internal connections within JFK's terminals.