

Introducing terminal competition at BAA's UK airports

Introduction

1. At various stages of the inquiry, some airlines have raised the possibility of separate terminal operation and development (STOD) with us, most recently and in most detail in the context of the Q5 price control review at Stansted: easyJet, supported by a paper produced by Frontier Economics, suggested that the building and operation of the second terminal at Stansted should be put out to tender by the CAA. The CC considered that this option, dubbed Terminal Development Tendering (TDT), would be more appropriately dealt with in the context of remedies in the market investigation, due to the legal issues preventing its implementation at Stansted during Q5. The vast majority of arguments that apply to TDT also apply to STOD more generally. The most notable complication resulting from TDT is the involvement of the regulator in the selection of the independent terminal operator via a tender process. Throughout this appendix, we refer to STOD, except where the point discussed only applies to TDT.
2. We first introduce various models of independent terminal operation, including easyJet's proposal, terminal operations at JFK and the solution pursued for the development of a second terminal at Dublin Airport. We then assess the effectiveness of STOD as a remedy to the adverse effects on competition we have found and consider the legal issues that would need to be addressed to make this a viable option.
3. We conclude that, while STOD possesses some attractive features, it is unlikely to be fully effective in addressing the AEC and range of detrimental effects on customers provisionally found by the CC and could result in significant costs and inefficiencies. It may, however, have a role to play in the future in addressing some of the

detrimental effects on customers of the adverse effect of certain market features on competition, particularly at Heathrow. Much will depend on the detail of the way in which it is implemented, and further consideration of this option should be left to the specialist aviation regulator when an opportunity presents itself. The current review of the regulatory framework should, if possible, eliminate any legal barriers to the implementation of STOD.

Models of independent terminal operation

4. This section introduces the TDT proposals put forward by easyJet and a small selection of case studies of independent terminal operation. It is worth noting that across the world many governments, particularly in the developing world, have sought to adopt variants of STOD,¹ as a path towards the partial privatization of infrastructure assets.

TDT

5. Under the proposal developed by Frontier Economics on behalf of easyJet, the provision and operation of terminal facilities would be separated from the provision of the monopoly access services (eg runways, taxiways, aprons etc...). There are four key elements to the proposal:
 - (a) Bottleneck facilities (access to the airport and terminals) would continue to be regulated by the CAA through a price control framework.
 - (b) The right to build and operate terminal facilities (non-bottleneck facilities) would be opened up to competitive tender by the CAA. The selected terminal provider would have a fixed-term lease contract with BAA and the CAA would set the general rules on what would be included in the lease contract. Frontier Economics noted that the lease contract could alternatively be agreed by BAA through bilateral negotiation.

- (c) The tendering process for terminal capacity would provide a cross-check on the market demand for the runway capacity.
 - (d) Inter-terminal competition would arise as a result of the tendering process and would remove the need for regulation of terminal services.

- 6. BAA would continue to have responsibility for developing the airport masterplan, which would set out the overall scope for airport expansion at all levels. The CAA would give regulatory sign-off on the plan.

- 7. According to Frontier Economics, the regulatory framework:
 - (a) encouraged investment in new capacity (runway and terminal) that was consistent with market demand;
 - (b) encouraged the long-term efficient provision of terminal facilities (through inter-terminal competition);
 - (c) had low regulatory costs over time; and
 - (d) improved the determination of price controls by reducing the scope of the control.

- 8. For TDT to be viable at an airport, therefore, it requires:
 - (a) continued regulatory intervention at an airport to enable access to monopoly facilities to be regulated, but also to review the masterplan;
 - (b) growing demand within the airport, which will mean that there is, or is likely to be, sufficient traffic within the airport to make a new terminal economically viable;
 - (c) land within the airport for a new terminal, at a location at which access to the runways, taxiways and surface access facilities are straightforward; and
 - (d) the possibility of obtaining planning permission for the new terminal.

¹Terms used include: build-operate-transfer (BOT) and build-own-operate-transfer schemes.

JFK

9. The Port Authority of New York and New Jersey (the Port Authority) is a public agency which maintains transport infrastructure within the two states of New York and New Jersey. It receives no tax revenues from any state or local jurisdiction and has no power to tax. It relies almost entirely on revenues generated by facility users, tolls, fees, and rents.

10. The Port Authority controls three airports, JFK, La Guardia and Newark. For some years, it has allowed several large airlines to construct and operate terminals in its airports, while retaining the ownership and operation of the others. The Port Authority does not operate any of the nine scheduled airline terminals at JFK. The International Terminal (Terminal 4) at JFK is the only terminal not to be run by a large airline: it was built and operated by a consortium including Lehman Brothers and Schiphol. A new passenger terminal built by the Port Authority and JetBlue opened on 22 October 2008.

11. The Port Authority told us that it allowed airlines to own and operate terminals in its airports as it considered that they might have easier access to financing and might be able to operate them more efficiently than it could, though it considered that the empirical evidence on this was ambiguous. The desire to introduce competition between the terminals was not the motivating factor in the outsourcing of terminal construction and operation. The terms of the concession were typically a 50-year lease on the new facility, with the operator and the Port Authority collaborating in the design of the building, and the Port Authority being concerned to ensure that the facility had some value at the end of the lease. We understand from American Airlines that the Port Authority is fully involved in the design and operation of the facility. Charges for access to the runways do not discriminate between airlines that use a Port Authority terminal and those that use an independent terminal. There do

no appear to be significant operational complications caused by having different terminal operators with respect to the operations of the airlines who lease the terminals.

12. Other airlines do fly into independently-operated terminals, but these tend to be members of the same alliance as the operator. The Port Authority is responsible for ensuring non-discriminatory third party access to independently-operated terminals. An airline might consider the issue of confidentiality of information between itself and an airline which operated a terminal in making the decision whether to use that terminal, particularly if the two airlines were not in the same airline alliance.
13. Lessons which may be learned from the Port Authority's experience include the following:
 - (a) the operational complications caused by competing terminals appear to be solvable, but this may be because of the overarching role and public status of the Port Authority;
 - (b) separate ownership and operation of terminals does not guarantee competition between them, particularly when airlines are the owners and operators; and
 - (c) the importance of a non-discriminatory regime for access to common facilities is recognized.

Dublin Airport

14. Dublin Airport Dublin) is owned and managed by the Dublin Airport Authority (DAA), a state-owned company.
15. In 2002, the Irish Government invited expressions of interest for the construction and operation of a second terminal at Dublin Airport. A total of 13 organizations or consortia submitted expressions of interest, which, together with the overall concept

of an independent terminal, were the subject of an independent review. Below are some of the most interesting findings and conclusions of the panel report:

- (a) The majority of the benefits identified in the expressions of interest were incurred by airlines and centred on improvements in facilities and operational capability, lower cost and choice between terminal operators. From an overall airport perspective, the main benefits claimed were increased capacity and a better match of facilities with airline requirements. For the public, the main benefits claimed were in improved facilities, choice of new routes and services provided by carriers in the new facility, a reduction in the cost of car parking and improved access.
- (b) The proposals highlighted that it would be important to separate properly the costs of individual components of service delivery and ensure transparent and fair pricing at the incumbent operator's terminal; concerns were also expressed about the incumbent operator's conflicts of interest as the owner/operator/regulator of airside facilities.
- (c) The review panel concluded that average net cost of the incumbent operator of its services on a per passenger basis would rise in the short term, as the costs would be spread over fewer passengers.
- (d) The review panel concluded that an independent terminal provided by an independent operator would stimulate effective competition at Dublin, through increased capacity and quality of terminal services,. Such a terminal would give airlines a choice between terminal operators, provided that sufficient capacity was available in the new terminal from day one to enable individual airlines to switch some or all of their services. This would result in improved management focus on customer service, the provision of best practice airport facilities, increased customer choice with a wider range of destinations and operators being offered.

- (e) The review panel also considered that the following fundamental regulatory prerequisites were necessary: operational regulation to ensure fair and equitable access to shared infrastructure, and transparency of costs for individual components of the services provided to ensure that shared activities were not cross subsidizing competing related activities.
- (f) The panel concluded that none of the issues identified were insurmountable and that an independent terminal was a viable strategic option for the development of Dublin.
- (g) The review panel recognized that airport operators internationally had raised the loss of unified airport control as one of the key reasons against competition at an airport, but considered that effective communication between the parties should produce agreement on the allocation of infrastructure funding and revenue generation. The panel therefore did not attach undue importance to this perceived difficulty.

- 16. However, in May 2005, the Government issued an Aviation Action Plan that, inter alia, awarded the design and building of the second terminal to the DAA. It seems that some parts of the operation of the terminal may be outsourced, as at some non-BAA airports in the UK.

Other examples

- 17. There have been examples of failed separation of terminal and airfield operation, the most notable being those at Toronto and Brussels.
- 18. Development of Toronto's Lester B Pearson Airport's third terminal, with a capacity of 10 to 12 mppa, was carried out under a build-own-operate-transfer arrangement. The deal included a 40-year lease, with an option to renew for an additional 20 years, a lump sum payment to the Government and an annual lease payment based on

developers' gross revenue. The government body, Transport Canada, owned and operated Terminals 1 and 2, whilst a third terminal was under private ownership, with Lockheed Air Terminal of Canada Inc operating it under a management contract. Transport Canada coordinated activities, provided air traffic control, and was the proprietor of runways and taxiways. Charges at Terminal 3 were twice as high as those at other terminals. The market was segmented, with a compulsory allocation of airlines to Terminal 3: the more prestigious international carriers tended to use Terminal 3, while low-cost and regional carriers mainly used the other terminals. The independent ownership ended after six years and Terminal 3's operator stated that it did not see a long-term viability in maintaining a terminal that was independent of the rest of the airport.

19. At Brussels, the decision was made in 1987 to bring in private finance to build a new passenger terminal. As part of the deal, the independent operator was able to operate the terminal independently, while the airport authority retained the management of the airfield. By 1998, the airport was reunified, on efficiency grounds. Commentators have pointed towards the different incentives at play as the main reason for the failure of the experiment: the airfield operator charged airlines according to the weight of the plane and was thus incentivized to seek heavy long-haul aircraft; the terminal operator on the other hand charged an individual price per passenger, which meant that it focused on cheaper, regional flights with a greater throughput of passengers.

Analysis of the effectiveness of the remedy

20. STOD can introduce an element of competition into the provision of terminal services, but it cannot affect other aspects of the provision of airport services, including runway and taxiway provision, and it requires managing by a regulator. It cannot therefore replace airport-on-airport competition but, where airports have substantial

market power, competition between terminals may be the only effective way that competition can be introduced.

21. The effectiveness of STOD is closely linked to its net effect on customer welfare. This will depend on the balance of benefits resulting from increased competition and efficiency losses. In particular:
- (a) Would the independent operation of terminals necessarily result in increased competition?
 - (b) What would be the benefits of this for customers?
 - (c) What additional costs and inefficiencies would result from terminal competition?

Competition between terminals

22. There is evidence that a terminal, managed by a truly independent third party, can introduce an element of genuine competition: the opening of Terminal 4 at JFK was welcomed by smaller airlines, some of which commented on the higher quality of service and non-discriminatory treatment they received at the new terminal. Between 2001 and 2007, 12 airlines transferred to Terminal 4.²
23. However, the introduction of independent terminal operation may not result in increased competition for the following reasons:
- (a) The advantages of STOD in fostering competition apply only as long as spare terminal capacity exists. MAG told us that, in its estimates, 20 per cent spare capacity was needed. Frontier Economics had on the other hand estimated that 10 per cent spare capacity was sufficient. If terminal capacity is fully utilized, both owners could replace any unhappy customers with new airlines, significantly reducing incentives to keep prices low and service quality and efficiency high. A separate terminal operator would have no more incentive than BAA currently

does to promote the provision of new capacity which disturbed its ability to charge the airlines scarcity rents.

(b) In practice, it seems from international experience that airlines are most likely to build and operate new terminals. This itself raises competition concerns, since airlines have incentives to block access by their competitors to the terminal facilities, or to charge them a high price to use the terminals. In the event that there is spare capacity in the airport operator's terminal, there would be some form of upper limit on the price which an independent operator of the other terminal could charge. However, it might simply pay the airline operator to allow the spare capacity to go to waste, since it would thereby face less competition for its flights. It may be possible to contain such behaviour with behavioural undertakings or intrusive regulation, but such regulation is unlikely ever to be completely effective, and would in any case reduce or eliminate the gain from less regulation from the introduction of STOD in the first place.

Claimed benefits of terminal competition

24. Nevertheless, STOD could, in principle, provide competition between terminals, with benefits to both airlines and passengers. A separate owner, designing and building a terminal from scratch, would have a powerful incentive to design a terminal which would attract airlines from the airport operator's terminal, and to price competitively. STOD would also, in principle, incentivize the efficient delivery of terminal services such as:

- (a) check-in desks;
- (b) baggage handling; and
- (c) security screening.

²See: www.atwonline.com/channels/routesAirports/article.html?articleID=1961.

25. An independent operator of a terminal at one of BAA's airports could be less bound by BAA's fears of confrontation with the trade unions, and would be more able to tackle many of the restrictive practices and relaxed attitudes towards items such as pensions and absenteeism which we have identified as problems in the quinquennial reviews and in our provisional findings. In our provisional findings, we confessed ourselves 'perplexed' that BAA did not take the opportunity which the opening of T5 presented to revise its working practices, but a new terminal operator would have an opportunity to do so.
26. The existence of an independent terminal would also be likely to provide BAA with an incentive to improve its own terminal services. It might therefore be provided with a discipline to improve its own operating practices and to design any new facilities with a view to its customers' requirements, rather than, as at present, the maximization of the RAB.

Loss of operational efficiency

27. It is generally recognized (even by those who support terminal competition)³ that this remedy could result in efficiency losses at the airport level. Virgin stated that at capacity-constrained airports, such as Heathrow, suboptimal utilization of terminal facilities would offset at least some of the gains from inter-terminal competition as efficiency might not be maximized.
28. Other examples of areas where loss of operational efficiency could occur include: gate allocation; allocation of staff across the airport; economies of scale in procurement; health and safety issues across the airport; and marketing.

³Many of the airlines that responded to the CAA's February 2001 consultation on the Competitive Provision of Infrastructure and Services within Airports raised such concerns. See: www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=614.

29. While it seems likely, based on international experience (eg JFK), that such issues could be overcome, unless there is a complete breakdown in relations between the airport operator and the separate owner, added operational complication and the need for coordination between two or more independent agents within an airport would be likely to result in increased costs and might require a level of regulatory intervention.

Planning issues

30. More problematic are the issues relating to long-term planning.
31. MAG told us that, if terminal facilities were owned separately from the airfield, balancing the capacity of terminals and runways would, in particular, become almost impossible; that the existence of legal structures (leases, ownerships) would build in substantial inflexibility for the future development of the airport; and that the ability of the airport operator to coordinate demand across the airport and expand facilities in the most efficient increments would be lost.⁴ MAG was also concerned that an independent terminal operator would not be able to have the airport operator's powers under the Town & Country Planning (General Permitted Development) Order, that enable it to undertake certain extensions to the terminal without submitting a formal planning application.
32. The TDT model put forward by easyJet presents additional difficulties:
- (a) Frontier Economics' claim in reference to Stansted that the construction of a second terminal under separate ownership and its heavy utilization would give some form of a 'signal' that a second runway would be required seems flawed. It is difficult to see how the signals would differ between commonly-owned and

⁴In this respect, we note that in general airports in the US tend to cover larger areas than airports in the South East of England. This would make the development and re-development of parts of airports independently from others more practical.

separately-owned terminals in this way, and there is no obvious reason why a second terminal should be built before a second runway, rather than vice versa. In addition, given the long lead time in the planning and construction of a runway, it is likely that any such 'signal' would come after the optimal date for commencement of work on that facility.

(b) The interaction between the terminal tender process and the planning process is also uncertain. If planning permission is obtained for a terminal before the ownership and operation is put out to tender, there would be scope for BAA to constrain the new owner's ability to manage the terminal via the inclusion of unhelpful design parameters or section 106 agreements.⁵ If the separate owner has to apply for planning permission, considerable uncertainties are inevitably introduced to the tender process. In any event, an integrated planning application for the terminal and runway, managed by one party would be more efficient and likely to be successful, given the typical concerted opposition to planning applications for airport developments.

Regulatory involvement

33. One of the main benefits of TDT (and of STOD more generally) claimed by Frontier Economics is the reduced regulatory intervention that would result from this remedy. This is, however, arguable, given the reliance of the new operator on BAA for core services, the need to design an effective tender process and the need for coordination both in operational and planning terms. It seems to us that, far from being necessarily reduced, the role of the regulator could increase and could be more complex than at present.

⁵The CAA could not seek planning permission.

Interface with common facilities (eg runway)

34. It seems generally to be agreed that any separate owner would need the protection of regulation of the interface with common facilities, to ensure that aircraft which use its terminal have access to runways and taxiways and that passengers can access the terminal building at a reasonable price.
35. The challenge of allowing third party access to common facilities, while the owner of the common facilities continues to own an upstream business has been faced in other regulated sectors, with mixed success. For example, in gas, British Gas was required to offer third parties access to its network by the Gas Act, 1986, while it continued to own its upstream business, but this arrangement was not considered to be a success, and the common carrier was eventually separated from the upstream business. In post, Royal Mail is required to allow third party access to its mail centres and delivery offices, while it continues to collect and sort mail itself. This arrangement has been highly successful in boosting competition in collection and sorting, because access charges were set relatively low, but Royal Mail considers that the financial viability of its delivery network has thereby been impaired. In other areas, companies, for example BT and electricity companies such as EdF, Scottish Power and Scottish and Southern, continue to have an involvement in both regulated and competitive sectors, but there is a relatively onerous regulatory regime requiring full separation between the different parts of their businesses.
36. It is possible to set and enforce access arrangements, but it is a complicated task, for a number of reasons:
- (a) the allocation of costs between the monopoly and other parts of the regulated business is complicated and involves arbitrary judgements;

- (b) any charges set may either be too generous to the monopolist, and so stifle competition, or too generous to its competitors, and so jeopardize the financial viability of the monopolist;
- (c) the monopolist controls most of the relevant information, and has an incentive to release only those items of data which suit its case;
- (d) there are inevitably many opportunities for parties, especially the monopolist, to evade any controls imposed; and
- (e) any arrangements must be sufficiently robust and flexible to take into account operational realities and to adapt as necessary.

37. The essential component of such a regime is an active, interventionist regulator, willing to intervene when necessary in order to protect effective competition.

Non-discriminatory access to terminal facilities

38. As mentioned above, it seems likely that any separate owner would be an airline, or a consortium involving one or more airlines. As mentioned above, this raises competition concerns, since it might be in that airline's interests to discriminate against its competitors. It is possible, therefore, particularly if capacity is tight at the airport operator's terminal, that it might be necessary to require any separate owner to provide non-discriminatory access to its facilities. This would cause significant regulatory difficulties, since charges and non-price conditions would have to be regulated, and this regulation would have to be enforced. It may be, therefore, that the regulatory regime under STOD would be as onerous as the current system.

39. For this reason, in some other UK regulated sectors, there is a ban on regulated monopolists undertaking upstream or downstream activities. For example, the National Grid was prohibited from generating or supplying electricity itself, and Railtrack was prevented from owning or operating trains, in competition with their

customers or suppliers. It may be appropriate to consider similar arrangements for a terminal tender process.

Defining the terms of the lease

40. The terms of the lease are crucial in deciding how TDT would work in practice. There are a number of ways in which a tender could be implemented. Either an outline of the main features of a terminal could be specified, or the terminal could be described in detail in the tender documents, or parties could be invited to describe the terminal with minimal guidance. The length of the lease is also a crucial factor. If it is too short, the separate owner will not be able to recoup the initial capital outlay.
41. Other issues need to be addressed in designing a lease, including procedures if the separate owner becomes bankrupt, and arrangements to ensure that the separate owner does not unduly neglect the facilities when the lease is about to end.
42. The experience of the Port Authority seems to indicate that, under American conditions, it is possible to address these issues to some extent. Separate owners can obtain 50-year leases, and must agree the design of their facilities with the Port Authority. However, the circumstances are so different that it would be necessary for any future regulator wishing to design a TDT process to do so more or less from scratch.

Planning

43. Frontier Economics envisaged that the CAA would merely sign off the masterplan. However, given the potential problems relating to planning that we have identified above, it is very likely that the CAA would in practice need to carry out a detailed review of the plan. We note that normally, where terminal competition has been introduced in other parts of the world, a public agency is responsible for the airport

masterplan, thus removing the need for an independent review and unnecessary regulatory costs.

44. In particular, an airport operator may be faced with the decision of either expanding a terminal or building a new one. This consideration would take into account: the most efficient size of the airport; availability of land; technical difficulties etc. In this case, this decision would be distorted by the incentive of BAA to avoid the implementation of TDT and might result in a suboptimal size of terminal facility. In practice, the regulator would need to establish when a new terminal would be needed.

Legal issues

45. From a legal perspective, it is necessary to consider: (a) whether STOD is a remedy that the CC can impose under its market investigation powers; and (b) whether STOD could be introduced using existing legal powers (eg under the Airports Act), or whether changes to the law would be needed.
46. In addition to the question of whether additional land for a new terminal could be acquired by compulsory purchase if it were to be owned and operated by a party other than the operator of the remainder of the airport, there are a number of other issues.
47. In particular, an obligation requiring competitive tender of a contract to design/build/operate new terminal facilities appears to raise different issues from where there was an obligation requiring an airport operator to enable a third party to offer competing terminal building services to airlines from an existing terminal at that airport, (eg at Gatwick, between North and South terminals).

Can the CC impose STOD as a remedy?

48. The CC has identified the current system of regulation of designated airports as a feature which has an AEC. In particular, the CC considered that: (a) Heathrow's position as the only significant hub airport in the UK is a feature that may continue to restrict competition between airports, so that regulation may continue to be required for Heathrow for a prolonged period; and (b) Aberdeen does not appear to be subject to any significant potential constraint from other airports and its local market position is a feature which has an AEC.

49. If STOD is introduced as part of a reform of the current system of regulation, it appears that it may mitigate or remedy these AEC, or the detrimental effects on customers, by making capital programmes and service levels at these airports more responsive to customer needs.

50. In such a case, the CC has then to decide whether it is reasonable or practicable to take action by way of accepting final undertakings or making final orders.

51. The CC also has power (under section 54 of the Airports Act) in such a case to modify or revoke conditions imposed by CAA on an airport operator, in order to remedy an AEC relating to the carrying on of any 'operational activities' at the airport.

52. However, the power to modify conditions relating to the carrying on of operational activities would not appear to extend to requiring an airport operator to introduce STOD, either to design/build/operate a new terminal building, or to enable a third party to offer competing services from an existing terminal building, as these are not matters which are currently covered by conditions.

53. It appears that the CC would have the power to seek undertakings from an airport operator or make orders as regards existing terminal buildings, or even as regards future buildings. However, this is likely to raise difficulties in monitoring such arrangements, and the relationship and enforcement of any such undertakings or orders to conditions applied under the regulatory regime of the Airports Act is likely to be complex.
54. Alternatively, the CC could decide that, rather than take direct remedial action, it should 'recommend the taking of action by others for the purposes of remedying, mitigating or preventing' the AEC, in accordance with section 134(4)(b) of the Enterprise Act. In such circumstances, the changes necessary to introduce STOD would be made through the regulatory regime, and any necessary amendments to the Airports Act.

Can STOD be introduced using existing legal powers?

(a) The right to design/build/operate

55. The effect of the Airports Act is that the seven BAA airports in the UK are owned and operated by BAA, whereas in countries where STOD is used, the airport is owned by public authorities, albeit operated by private entities.
56. The Airports Act gives the CAA powers as regards the use of airports (through its air transport licensing powers); and as regards operational activities at the airport, economic regulation etc. However, the Airports Act does not give any power to the CAA to require BAA to award contracts for new terminal buildings by competitive tender, nor to require BAA to have new terminal buildings operate in competition with existing terminal buildings at an airport, through the grant of concessions or anything similar.

57. Inasmuch as a requirement to enable a third party to offer competing terminal building services at an existing terminal may amount to a partial divestment of BAA's business, it may be within the scope of Schedule 8 of the Enterprise Act and so within the power of the CC to order. However, the position appears to be different for future terminal buildings, which do not form part of BAA's business. Where any future divestment of part of the airport business or land for these purposes is an issue, it appears that this could only be done by legislation—probably primary legislation in the form of amendments to the Airports Act.
58. In addition, other connected rights would need to be given to the third party—for example, a right of access to the runway and other parts of the relevant airport.
59. Other legal questions would arise on the relationship of such a new arrangement to the current regulatory scheme. These would include:
- (a) Would the operator of a competing terminal be an 'airport operator'?
 - (b) Would charges made for using a competing terminal be 'airport charges'?
 - (c) Would the competing operator be subject to a price cap if the airport operator was subject to such a cap and, if so, how and when would this be calculated?
 - (d) Would the CAA have regulatory powers to monitor the arrangements between airport operator and terminal building operator—for example, in connection with fair and non-discriminatory charges and access to the runway from the competing terminal.
60. It appears that, if primary legislation was passed to enable STOD to take place, these additional matters might be capable of being covered by existing provisions of the Airports Act, but it is assumed that any additional provisions that were considered necessary would be enacted at the same time.

61. In short:

- (a) A terminal building is not an airport, but is part of an airport. The operator of a leased terminal building may be in no different a position than the operator of a leased car park at the airport. It may be straining the scope of the definition of 'airport operator' to make it extend to include 'the operator of a leased part of an airport'.
- (b) 'Airport charges' are, in effect: (a) the landing charge; (b) the aircraft parking charge; and (c) the departing passenger charge. Charges made by a third party operator of a passenger terminal would not easily come within this definition.
- (c) If it is correct that the charges made the operator of a competing terminal are not 'airport charges', and that the operator of a competing terminal is not an airport operator, the issue of a price cap will not arise. Such a view is consistent with the rationale for price caps at designated airports being the need to control the market power of the airport operator (as the operator of a competing terminal building is unlikely to have the necessary market power).
- (d) There may be scope for the CAA to use its power to impose 'conditions' on the airport operator, in order to require the operator to give access from runway to competing terminal building on reasonable and non-discriminatory terms, and for the CAA to monitor compliance thereafter.

Conclusions and applicability of STOD at BAA airports

62. STOD seems to offer some advantages over separately-owned airports with no competition, if those airports possess sufficient market power to be price controlled. There is also at least some evidence from international experience that separate ownership and operation of airports is possible. However, the claimed benefits resulting from separate terminal operation are uncertain, while additional costs would almost certainly be incurred under such a model. In addition, the legal framework is currently a major impediment to the implementation of STOD at any BAA airports.

63. However, we recognize that terminal competition has the potential to benefit airlines and customers in the future and are of the view that it should be considered as part of the DfT's review of the regulatory regime to allow scope for such an option to be pursued in future.
64. Turning to the feasibility of this remedy at BAA's airports: evidently STOD can only introduce competition at airports which have more than one terminal. It therefore can only be a potential remedy at Heathrow, Gatwick and potentially Stansted, if planning permission is given to the extension of the airport. Masterplans show that second terminals may be built at Edinburgh, Glasgow and Southampton, but these developments are currently too speculative to be relevant to our present inquiry.
65. BA commented that Heathrow was a hub airport, and STOD would be very difficult there because it was congested and highly integrated. There might be more scope for STOD at point-to-point airports.
66. Virgin was a supporter of STOD, but recognized that there were several impediments to its possible application, scope, operation and effectiveness in the UK, particularly due to the significant capacity constraints that existed. For example, at Heathrow and Gatwick, inter-terminal competition might not maximize efficiency due to its impact on the most efficient use of facilities. Virgin nevertheless believed that STOD could potentially be achieved at Gatwick through the sensible development of different facilities making them attractive propositions for sub-ownership. One potential option would be to have different products at the different terminals, but if there were another runway then more terminal capacity would be needed, which would offer the option of looking at different models.

67. We agree that the integrated nature of Heathrow and, in particular, the complex airline moves between terminals—which will be necessary over the next few years as part of the redevelopment of the airport—limit the prospects for STOD at Heathrow in the short term. However, if a sixth terminal were to be built, as currently envisaged by BAA, there would appear to be no reason in principle why this could not be funded and operated separately from the other terminals. A STOD or TDT remedy relating to Heathrow Terminal 6 could only be implemented after a careful analysis of its costs and benefits. This could only be carried out, once there is more certainty about this development and would be best handled by a specialist aviation regulator. We note that the large excess demand at Heathrow and resulting persistent capacity constraints suggest that STOD for Terminal 6 (or any of the other terminals) may not result in effective competition. We also note that this terminal will be located on land which is currently not owned by BAA and that in all likelihood this land would need to be purchased using CPO powers. This might raise substantial practical and legal difficulties if the building of the terminal were put out to tender by the CAA.
68. We see no reason in principle why the two terminals at Gatwick could not be operated separately, should the legal framework make this possible.
69. At Stansted, it would be difficult to carry out a TDT remedy in the short term, given the timetable for the opening of the new terminal. However, it is currently envisaged that the terminal will be only be fitted out for 10 mppa, there is no reason why in future, this terminal could not be developed further and operated by a separate terminal operator.