



NON CONFIDENTIAL

BAA's Response to
Q5 Potential Public Interest Issues
Raised by Airlines and Others

BAA/CC2007/248

BAA Limited
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1. Introduction

- 1.1 This document provides BAA's initial response to the Commission on the points made by third parties. At this stage, the responses are provided at a high-level and are intended to inform further discussion with the Commission on the issues raised by third-parties. BAA would be pleased to provide further detail on any of the issues in this paper if required.
- 1.2 The concern put to BAA by the Commission is highlighted in italics at the beginning of each section. BAA's response to each concern then follows.

2. Comments on the Ferrovial acquisition and how it will affect quality of service.

2.1 *The Commission requested comments from BAA on the acquisition by the Ferrovial consortium and how that will affect the quality of service at its airports.*

2.2 BAA is committed to the smooth running of the airports, and passenger service and safety remain our main priorities. Grupo Ferrovial ("Ferrovial"), as well as our other shareholders, are fully supportive of these objectives as demonstrated by the recent investment in additional resources - people, processes, systems and infrastructure - to react to the security disruptions of the last year. This investment has been made without any guarantee that it could be recovered in the regulatory environment.

2.3 In summary, BAA considers that the acquisition will lead to an improvement in the quality of service provided at its airports. This will be delivered by the commitment of additional resources to improving the day-to-day passenger experience, and supported by a significant programme of investment to transform terminal facilities.

3. Related party transactions (Swissport, Amey, Ferrovial Agroman and others)

- 3.1 *The Commission requested details on how BAA will deal with other parts of Ferrovial (including Swissport, Amey, Ferrovial Agroman and any others) who might be engaged as suppliers or contractors to BAA or to offer services at its UK airports.*
- 3.2 The Shareholders Agreement (between Grupo Ferrovial S.A, Ferrovial Infraestructuras S.A., Caisse de Deppot et Placement du Quebec, Airport Infrastructure Fund L.P., Baker Street Investment Pte Ltd, FGP Topco Ltd and Lernamara, SL) sets out the policy for any related party transactions between BAA and any of the shareholders' subsidiary companies. Under the terms of the agreement, any dealings with related parties must take place in an open and competitive basis, and on arm's length terms and conditions.
- 3.3 Following acquisition, Ferrovial Agroman has been qualified as a framework supplier by BAA after going through the same assessment process as the rest of our suppliers. Dealings with Ferrovial Agroman, as with other suppliers, will remain at arms length and will have to comply with the normal tendering process for any BAA projects. They will only be awarded contracts if they are the optimal supplier for that project.
- 3.4 The provision of ground handling services is agreed between the airlines and the handler. BAA does not provide ground handling services nor does it get involved in transactions between ground handlers and airlines except for providing access to the infrastructure to all ground handlers in accordance with the Airport (Groundhandling) Regulations 1997.
- 3.5 BAA has always conducted its negotiation with, and appointment of, framework suppliers with an appropriate level of transparency. Our investment plans and subsequent delivery are subject to regulatory scrutiny by both the CAA and the CC and airlines are actively involved in the project processes.
- 3.6 The combined effect of the above is that BAA conducts its business in an appropriate and transparent manner, ensuring capital investment is undertaken efficiently, to the benefit of users in a fair and equitable manner.

4. Issues raised by airlines

4.1 Introduction

4.1.1 BAA notes that following the last price control review, we introduced a “Dispute Resolution Process” that airlines could follow if they were unhappy with how BAA had dealt with a particular issue. The submissions received from airlines should be considered in the light of the fact that none of the airlines that have submitted complaints have opted to use the dispute resolution process.

4.1.2 BAA would therefore suggest that the issues raised by airlines should not necessarily constitute public interest complaints. In addition, BAA notes that no airline chose to use the existing section 41 power of appeal to the CAA during the current quinquennium. BAA suggests the Commission ask all the airlines to explain why they opted not to use the existing dispute resolution processes before bringing a public interest complaint.

4.2 Inadequate consultation

4.2.1 *Airlines claim BAA has inadequately consulted on capital expenditure including; lack of adequate or timely provision of information on project specific costs, on-costs and risk monies; on capital expenditure at Heathrow including HET, pier service provision in general and at Terminal 5 in particular, stand provision, the Eastern Apron development and the decision to adopt horizontal rather than vertical segregation of inbound and outbound passengers at Terminal 3 Pier 7; and on capital expenditure at Gatwick, including the recent significant increase in capital expenditure plans.*

Heathrow

4.2.2 The current level of consultation and information on investment (via the Constructive Engagement process) is unprecedented in BAA’s history. Plans for Heathrow East Terminal (HET) continue to be discussed in detail with the STAR Alliance airlines and with the airline community through the HET Project Board, established in March of this year. In addition, a joint BAA/airline project board for the Eastern Apron, also established in March, is in place at which HET plans are discussed in the context of overall Eastern Apron development.

4.2.3 In addition to more detailed discussions through the project boards, BAA presented the high level HET cost plan to the June 2007 Airline Consultative Committee (ACC), followed by a more detailed discussion at the capital investment program (CIP) workstream workshop on 18th June 2007. This discussion included an overview of revenue and

operating cost assumptions used to form the business case for the eastern campus as a whole.

- 4.2.4 Regarding transparency, as the capital investment program (CIP) has been developed through airline engagement over the course of a number of years, details of the costs have been provided to the various airline working groups engaged with BAA. Membership of the working groups is open to all airlines. However, not all airlines chose to be engaged in all workstreams.

Gatwick

- 4.2.5 At Gatwick, we have detailed the process we went through with the airlines to align an airport investment plan with the strategic aspirations of airlines, most critically with regard to the delivery of pier service to acceptable levels throughout Q5. After exploring a range of options we have proposed what we consider to be the most financially viable and effective solution (Pier 7). The robustness of the alternative proposals from the airline community had not been tested to the same extent as those of BAA and we believe could not deliver the same benefits. Indeed, those alternative proposals could potentially have increased the requirement for long term investment.

Heathrow and Gatwick

- 4.2.6 Airlines also claim BAA has inadequately consulted on the management of security issues, including BAA's decision to improve the security queuing standards without consulting on the costs and benefits of doing so. BAA accepts that it could have consulted with airlines earlier in the process. However, airlines have now been given full sight of BAA's security proposals and discussions continue.
- 4.2.7 Airlines further claim BAA has inadequately consulted on non-regulated charges, where BAA is said to have been slow in sharing forecasts with airlines. The level of non-regulated charges is covered in the main by the existing Specified Facilities conditions. BAA has stated its intention to base charges on costs: this principle has been agreed through the Constructive Engagement process, and it is not clear to BAA why airlines are seeking to reopen an issue on which agreement had been reached by raising it with the Commission.
- 4.2.8 With regard to Q5, BAA has suggested an approach to recover costs for specified facilities. The principles for Q5 were agreed with the relevant airline working group during 2006 and an agreed statement to that effect was included in the Joint Steering Team update to the CAA dated February 2007, at which point the working group's role was considered to have been concluded. Now the issue has been re-opened, we have reallocated responsibility for the workstream and informed the airlines of the new contact.

- 4.2.9 There have also been accusations that BAA refused to disclose, on grounds of confidentiality, much of the information required by airlines to verify the basis of non-regulated charges. During part of 2006, BAA was unable to share the detailed cost forecasts for this area because of the restrictions on disclosure while BAA was subject to a takeover offer. Subsequent to the acquisition, BAA provided detailed forecasts of the charges under the principles agreed.
- 4.2.10 BAA agrees the basis of any increase in non-regulated charges that airlines pay to BAA via the Constructive Engagement process. The CAA has set out BAA's stated intention in paragraphs 7.7 to 7.13 of its March 2007 document to the Commission. This includes reflecting full cost recovery, no substitution between charges, increases in outside supplier charges to be recovered, annual updates of cost estimates to be provided to airlines and agreement to explore pricing structures with airlines.
- 4.2.11 In conclusion, BAA does not accept that it has failed to provide sufficient information on non-regulated charges.
- 4.2.12 Airlines also claim BAA has not provided information on commercial incomes. BAA will not release details of a commercially confidential nature to airlines. In its model of Constructive Engagement, the CAA determined that non-regulated revenues such as retail income would be examined by the regulator and not form part of the Constructive Engagement process. It would be unreasonable for the Commission to make an adverse public interest finding in this area when BAA has followed explicitly the guidance of the CAA. BAA notes in addition that, other than the revenues of WDF, BAA's commercial revenues are published by the CAA.
- 4.2.13 In conclusion, BAA does not accept that we have inadequately consulted with the airlines. Indeed, we contend that the level of consultation in Q4 has been much more extensive than previously. However, BAA acknowledges that there are some limited areas for improvement (for example, as referred to at paragraph 4.2.6 above), and commit to continuing to improve the consultation process. However, we do not accept that there is any lack of commitment or desire by BAA to do so.

4.3 Disposals of assets without consultation

- 4.3.1 *Airlines have raised the issue of disposals by BAA of assets without consultation which could be required for future operational use.*
- 4.3.2 It is worth noting that there is no requirement under the Airports Act to consult on disposal of assets. When disposing of assets, BAA seeks to obtain maximum shareholder value

while ensuring the ongoing operation of the airport is not prejudiced by e.g. selling with safeguards for potentially needed properties, from any disposal. BAA notes that the CAA's current treatment of regulated asset base disposals – i.e. requiring that disposals be assessed at market value – gives full value of any transactions to the airlines. Given the sensitive commercial nature of such sales, it would be highly likely that any consultation with other parties would compromise any negotiations. For this reason, we have not consulted, ex ante, with the airlines on asset disposals.

- 4.3.3 It is of course open to the Commission to examine any potential public interest issue arising from such transactions. We regard this as sufficient control.

4.4 Fuel storage at Heathrow and the response to the Buncefield fire

- 4.4.1 *Airlines claim BAA failed to plan adequately to increase facilities for fuel storage at Heathrow or make available the necessary land, and failed to coordinate an adequate response to the shortage of fuel supplies resulting from the Buncefield fire.*
- 4.4.2 The allegation that BAA inadequately planned for a fuel supply shortage is without foundation. Indeed, it was only the failure by oil companies to develop a contingency plan for their own infrastructure at Heathrow that led BAA to take the lead on developing such a plan itself. As a result, the Fuel Contingency plan was agreed with Heathrow airlines in early 2005, in which participation by airlines was on a voluntary basis.
- 4.4.3 It should also be noted that on-going compliance with the recommendations of the Fuel Contingency Plan was on a voluntary basis. Part of this agreement was that base carriers were given a more generous percentage fuel allocation, which was adhered to until February 2006 when the allocation was equalised.
- 4.4.4 As part of the T5 development a new fuel depot was constructed, at Heathrow Airport Fuel Company's (HAFCo) expense, following an exhaustive concept study to determine the required capacity. Upon its opening in August 2005, fuel storage capacity increased from approximately 26 million litres to 60 million litres. In addition two temporary storage tanks that were constructed as interim measures during the construction of the new fuel depot have been retained, adding a further 6 million litres of storage capacity, taking the capacity to 66 million litres. The retained use of these interim tanks will be reviewed in 2008.
- 4.4.5 The key issue regarding fuel at Heathrow is the ability of the oil companies to supply the airport with adequate volumes. Fuel storage at the airport is an important, but secondary, issue. BAA conducts regular long term fuel volume planning exercises with major oil companies and airlines. With regard to asset disposals (see 4.3 above), no land suitable

for fuel depot expansion has been disposed of as part of the APP property deal, or any other deal.

- 4.4.6 It should be noted British Airways is also a fuel buyer in its own right and as such is well placed to influence the oil industry in terms of supply and storage.
- 4.4.7 BAA accepts the need for a greater volume of fuel storage capacity at Heathrow. However, BAA must operate within the constraints imposed on it in this respect by planning and other considerations; at present the land use allocation available to BAA for development is fully committed to delivering the master plan as agreed with airlines. BAA is currently in discussion with British Airways, the AOC, Virgin and other stakeholders to review the master plan and identify at the earliest opportunity suitable land for the expansion of fuel storage.
- 4.4.8 In conclusion, BAA does not accept the airlines' allegations that the current need for expanded storage capacity at Heathrow is a result of BAA's failure to plan adequately for such capacity expansion.

4.5 Intra-airport competition

- 4.5.1 *Some airlines have identified that there is a lack of intra-airport competition from separately owned terminals or in the development of new terminals or in competitive tendering for airport operation. Some airlines from whom the Commission have heard, however, did not believe there was scope for intra-airport competition, given the shortage of capacity at the airports.*
- 4.5.2 As set out in our submission BAA/CC2007/100, the CAA, as part of its initial consultation on policy issues, considered the question of introducing greater competition into the airport sector. As part of that consultation exercise, BAA provided a detailed response (BAA/Q5/139) to the issues raised.
- 4.5.3 That response highlighted the legal issues associated with introducing terminal specific competition which would lead to a significant increase in the operational difficulties and regulatory burden. It demonstrated that where authorities had attempted to introduce competition in the development of new capacity this appeared to lead to delays in the provision of new capacity, as shown by the recent Dublin airport experience.
- 4.5.4 BAA submits that this is not an area where the facts would justify an adverse public interest finding.

4.6 Differential charging between terminals

- 4.6.1 *Airlines identify the issue of a lack of differential charging (other than under the SQR scheme) between terminals to reflect different quality of service, for example between South and North Terminal at Gatwick, or, in future between Terminal 5 and Terminals 1 and 3 at Heathrow.*
- 4.6.2 As per our submission BAA/CC2007/100, BAA aims to provide an equivalent product to airlines but airports by their very nature are dynamic environments where facilities will differ at particular points in time due to the need to keep the airport operational while developing and renewing facilities. Although different facilities might 'feel nicer' this is because they are newer rather than because they have been built to a different standard. Given the phased nature of developments at airports it is not surprising that some terminals will be perceived to offer a higher service level. Over time and as further development occurs other terminals will become 'preferable'. During the Constructive Engagement discussions on the capital investment at Heathrow, airlines have emphasised the need for competitive equivalence, not differential pricing.
- 4.6.3 BAA has undertaken some initial work to determine whether it would be possible to introduce differential prices between terminals and it believes that such differential prices could be incorporated into the current airport charges system. In principle, such a change in pricing approach would be revenue neutral to BAA, but it could lead to significant changes in the relative prices which individual airlines paid to BAA, resulting in winners and losers among the airline community. Proposing such an approach is therefore likely to lead to objections from airlines, disputes over the appropriate method for calculating terminal specific charges and potentially allegations from airlines of discrimination in the allocation of facilities.
- 4.6.4 A further complication with moving to differential terminal pricing results from the highly congested nature of the terminals. Normally differential pricing is used as a means of offering different service propositions at different prices. However, given the space constraints at both Heathrow and Gatwick a move to differential pricing cannot easily result in airlines moving terminals. The capacity constrained nature of the airports raises concerns regarding the impact on operational effectiveness at the terminals if terminal differential pricing was introduced.
- 4.6.5 However, it is the case that differential pricing might be one way to reflect differing service standards within our airports, provided there is sufficient capacity to allow airlines to switch between terminals to avail themselves of differential prices for differential services. Differential prices have been introduced, for example, in Glasgow.

- 4.6.6 It should be noted that it is not straightforward to develop differential prices. There are a number of different methodologies which could be adopted when setting terminal differential pricing. For example, they could be set on an accounting cost basis, on a marginal cost basis, on a “market value” basis, on a service quality basis or using some other methodology. At Heathrow for example, some methodologies might see British Airways paying a lower price for Terminal 5 than for other, older terminals.
- 4.6.7 BAA would also be concerned if differential pricing was to be introduced at Heathrow prior to the completion of the airlines moves as this would add to the logistical difficulties that already exist.
- 4.6.8 On balance, BAA sees merit in the possibility for differential prices. We note however the airline reaction that we might expect this proposal to cause. If the Commission is minded to suggest BAA should introduce terminal differential pricing, we would ask that clear guidance is given as to how any form of differential pricing should be developed, including the methodology for calculating the differential, as well as considering a workable timeline for introduction.
- 4.6.9 To be clear however, BAA does not consider the lack of differential pricing to be a course of conduct against the public interest.

4.7 The flat rate structure of the runway charges

- 4.7.1 *The Commission received complaints regarding the flat rate structure of the runway charges, which, one airline argued, could disadvantage operators of short-haul aircraft and fail to reflect differences in the costs of handling larger aircraft, particularly the A380 when it operates at either airport.*
- 4.7.2 BAA firmly believes that it is appropriate to have a flat rate charge given the slot constrained nature of the runway at Heathrow. Any aircraft landing at Heathrow imposes costs on other airlines and passengers through the use of a scarce resource and the delays that any aircraft occasions on other aircraft.
- 4.7.3 It is a standard economic principle that prices should be set at marginal cost in order to achieve the most economically efficient outcome. Hence, in order to achieve the economically efficient use of the runway the airport charge should be set at a level equal to marginal costs, which should reflect short term costs in the form of congestion costs imposed on passengers and airlines. However, given that BAA’s overall charging level is constrained by a price cap, it is not possible to set landing charges at the true marginal cost. Hence a proxy measure is used, namely a flat rate charge.

- 4.7.4 The flat rate charge increases economic efficiency by ensuring that those who do not value the use of the runway as highly have an incentive to review their operation.
- 4.7.5 BAA's policy of a flat rate landing charge was reviewed by the CAA in the 1980s and found to be a legitimate policy. With the significant runway capacity constraints at Heathrow airport we continue to believe that a flat rate charge is appropriate.
- 4.7.6 BAA does not consider that its actions on this issue constitute a course of action adverse to the public interest.

4.8 Alleged attempts by BAA to monopolise IT services at Heathrow

- 4.8.1 *Airlines claim BAA has attempted to monopolise IT services at Heathrow, requiring airlines in some terminals to use BAA's IT services (such as CCTV and WIFI networks in Terminal 5) at charges in excess of market rates.*
- 4.8.2 The approach taken in the past (whereby each airline installed its own network within the terminal in which it operated) is no longer appropriate given the technology changes that have taken place in recent years. Previously, the original basic localised IT systems used by airlines and others had limited points of interaction and data interchange, and the installation and ongoing maintenance of these did not necessitate more rigorous control from the landlord. That is no longer the case, and unless there is a managed approach to the installation of networks, there will be excessive duplication but not complete coverage throughout a terminal. Given the demand from airlines, handlers, retailers, service providers and other airport participants for network services to be available throughout the terminals, it is sensible to have a consistent and managed approach to the installation and management of these.
- 4.8.3 As new terminal facilities are constructed or refurbished, the technology within them competes for space in constrained airport terminals which have stretching environmental (for example, excess heat, electrical and space concerns) and cost targets. Those environmental and space pressures demand that we minimise duplication of passive and active equipment. BAA as the landlord is uniquely placed to ensure that this is controlled on behalf of the whole community whilst giving proper consideration to the commercial and operational requirements of the occupants.
- 4.8.4 Regarding third-party input to specifications, BAA has involved airlines and partners where appropriate (e.g. the joint selection with British Airways of Aruba WiFi for T5). Where airlines have procured network services either directly or indirectly from BAA the service levels required are normally defined by the customer and BAA has endeavoured to comply with these within the bounds of the technical capability of the network.

- 4.8.5 Regarding charges at Gatwick for the common use check in system, charges are based on the costs of delivering the network connectivity required. At Gatwick, SITA has the direct relationship with the airlines for the supply of the CUTE service, and GAL is merely a subcontractor supplying the network element of that service to SITA. As far as we are aware, charges for the CUTE services were agreed in discussions between SITA and the Airline Operators Committee (AOC) at Gatwick. We had no reason to think that either SITA or the AOC were unhappy with the network charges we levy or evidence to suggest that the rates charged have been uncompetitive and would be happy to discuss this with SITA and the airline community.
- 4.8.6 Regarding British Airways' comments on CCTV, following a Government review on Airport Security in 2002 (Rt Hon Sir John Wheeler JP DL) it was recommended that a joint border agency and industry approach to assessing the threat and risk from serious and organised crime and terrorism at airports was set up. This led to the creation of MATRA. At the same time, the Home Office and the Department for Transport set up the Border Agencies Working Group whose output included a document entitled "The Use of CCTV at UK Airports: Best Practice Guidance". The Guidance essentially required the creation of a common use CCTV infrastructure at airports, access to which would be granted to the border agencies and to other relevant parties having an interest in airport security, such as airlines.
- 4.8.7 There are efficiency and effectiveness gains in creating a joined up approach to CCTV use at airports. The Guidance recommends that efforts should be made to ensure that there are not multiple cameras with similar views in use by different agencies unless there is a clear operational need. BAA has developed a CCTV policy for Heathrow which works on the basis of the Guidance and requires the use of the common system for common areas, but does allow the installation of a single user system in leased areas. Copies of this policy are available. Hence as regards CCTV, BAA has been following government guidelines by implementing common systems.
- 4.8.8 Regarding British Airways' comments on wireless networks, we would comment that having a common wireless infrastructure actually improves performance and maximises capacity. Wireless networks operate in unlicensed radio spectrum, and as such, if there are multiple competing networks, each such network would interfere with the other, and eventually there would be so much interference that no system would function properly. There is significant demand for wireless networks, not just from airlines but also from internet cafes, handlers who use this technology (e.g. for baggage reconciliation), and retailers who want to use wireless networks devices for stock control etc.
- 4.8.9 Aside from the issues over efficient use of the spectrum, as a responsible landlord and an employer we are obligated to show due care in effectively discharging the responsibility for electromagnetic health and safety with regard to customers, employees and tenants, and

we undertake to ensure that due care has been taken in assuring radio frequency systems deployed on BAA estates are in full compliance with UK statutory and subordinate legislation. If we manage the infrastructure we can be sure that it operates within permitted safety levels. To this end, we see benefits for all users of the airport in having a multi-user wireless infrastructure.

4.8.10 In conclusion, BAA does not accept airlines' claims concerning provision of, or charging for, IT facilities. We want to provide a safe environment for all users of the airport, and we also want to ensure that full network and services are available to all users.

4.9 High charges by BAA for services to passengers of reduced mobility

4.9.1 *Airlines raise the issue of high charges by BAA for services to passengers of reduced mobility and claim BAA also insists on taking those passengers through its retail outlets.*

4.9.2 We will need the Commission to provide us with more information on this claim. We do not charge for services to passengers with reduced mobility at Heathrow or Gatwick, the airlines organise these services. BAA does not insist on taking passengers of reduced mobility through its retail outlets but there may be accusations of unlawful disability discrimination if those passengers were unable to access the retail facilities.

4.9.3 It should be noted BAA has been consulting with airlines on how we are going to take over responsibility for this assistance service next spring, as we are required to do by new EU legislation.

Concerns from other parties

5.1 Heathrow taxis

- 5.1.1 *Complaints to the Commission included the constitution of Heathrow Airport Licensed Taxis Limited (HALT) and its contract with BAA; a 20p levy on taxis using Heathrow for use of the Journey pay credit card payment system; and the cost of using Heathrow.*
- 5.1.2 At the last CAA review, Heathrow's relationship with Heathrow Airport Licensed Taxis (HALT), including the collection of monies, was investigated by the Commission following a public interest finding. In a survey conducted, the vast majority of taxi drivers wished the arrangement with HALT and the taxi desks to continue. As requested, we have formalised the Heathrow/HALT relationship in a contract. We have just conducted our first service level agreement review as part of that contract which is in the public domain.
- 5.1.3 HALT provides an organisation to represent Heathrow taxi drivers and to operate the Taxi Information Desks in the terminals. Heathrow has undertaken a number of activities to ensure that HALT is an appropriate entity and that the use of the money collected from the drivers on behalf of HALT is appropriate and transparent.
- 5.1.4 The purpose of the taxi feeder park (TFP) entry fee is primarily to recover operational costs and it is not related to credit card payments. BAA will continue to levy the fee as long as the operation of the TFP has costs to recover.
- 5.1.5 Regarding complaints against the 20p element of the TFP charge, this is not an additional levy, but rather a small percentage of the TFP fee which BAA has, at the request of HALT and supported by the Trade at the Heathrow Taxi Trade Partnership (HTTP) Forum (which includes representatives of all major Trades recognised by Heathrow), reinvested into the operation to support new initiatives that improve the business for the Trade and the service to our passengers.
- 5.1.6 Journey Pay provides the platform that enable credit card payments. Contrary to allegations, there is no contract between Heathrow and the company called Journey Pay. No other credit card processors have approached BAA at any time to negotiate a commercial deal. BAA does not appoint credit card processors for taxis. Each driver makes his own decision on this and chooses whether to take credit cards.
- 5.1.7 In conclusion, BAA believes the issues raised are as a result of mis-information rather than actions by BAA which would lead to an adverse public interest finding.

5.2 Minibus charges

5.2.1 *The Commission received a large number of complaints about charges for use of Heathrow by minibuses more than doubling.*

5.2.2 Charter coach parking is a cost recovery activity. Charges are calculated by taking into account all direct (i.e. facilities and operations management, consumables etc.) and allocated costs (depreciation, common airport services such as Heathrow ambulance services, fire services, etc) of running the operation. The charges can be perceived as an access charge because bus companies pay a one-off roll up fee. However, the per entry charge is the only equitable basis on which to recover the costs from users, since the costs are basically the same regardless of the size of the coach.

5.2.3 BAA has traditionally under-recovered the costs of coach parking. Heathrow was due to raise prices in 2006 but delayed the increase at the request of coach operators. The coach operators using Heathrow are a highly fragmented group of companies, and for practical reasons BAA has only consulted the larger users. The minibus operators, representing a large number of different companies but a small percentage of total volume, would not necessarily have been aware of the background to the price increases.

5.2.4 Since BAA was made aware of the complaints from the minibus operators, the following action has been taken:

- Two projects have been initiated to look at a) quick wins and improvements that can be achieved in respect of service levels and b) the overall charter coach process. The first project started on 8 June 2007, with the feedback from operators being positive and constructive. We have agreed a bi-weekly forum for this project which is aiming to deliver operational benefits for this summer season. Also being discussed is differential pricing.
- Heathrow was keen to discuss the complaints directly with the smaller companies, and has contacted the companies concerned to arrange meetings. It should be noted that none of the operators previously involved directly in the pricing discussions raised a complaint with the Commission.

5.2.5 BAA understands the concerns of the minibus operators, but we believe that the charges for coach parking are reasonable given the cost recovery principles adopted.

5.3 Park & ride issues

5.3.1 *Complaints were made to the Commission concerning charges for picking-up and setting down passengers being driven to and from independent off-airport car parks; the location of the stops required to be used; the prohibition on the use of the airport name; and the*

use of the BAA website to refer only to their own services and not those of competitors. The concerns relate to other BAA and some non-BAA airports as well as to Heathrow and Gatwick.

- 5.3.2 At no time has BAA sought to deny access to the airport to any legitimate car park operator. There have been a number of changes to bye-laws and traffic regulation orders at all airports over recent years to address matters of public interest.
- 5.3.3 Congestion on airport forecourts has increased as passenger volumes have grown over recent years. There has also been a strong increase in the car parking 'valet' operators using the forecourts to collect and return passengers' cars. This congestion can cause significant delay to vehicles arriving at the airport, it is potentially dangerous for people circulating in the forecourt area and also creates a security hazard.
- 5.3.4 In response to this high demand for forecourt access, the airports have had to implement changes to rights of access which become enforceable through the traffic regulation orders and bye-laws. These traffic order changes at Stansted, Edinburgh and Gatwick have sought to provide the most convenient access points to the greatest number of users.
- 5.3.5 For the reasons stated above, the problems resulting from congestion have required BAA to attach priority for forecourt access to certain user groups. Every effort is made to ensure that within local physical constraints, user groups are re-located to convenient locations. In allocating scarce facilities BAA has adopted the principles of providing the facility for the greatest number of users. This has resulted in the on-airport operation being allocated facilities in preference to off-airport operators. However, where possible off-airport operators have been granted any remaining capacity and where there is no remaining capacity, secondary alternative facilities. In the case of the complaints from Secure Airparks, the alternative offered is less than 50 metres from the forecourt.
- 5.3.6 Although the valet operators returning vehicles to arriving passengers are now directed to the short stay car park, this is consistent with the approach being introduced for all 'meeters and greeters'.
- 5.3.7 BAA has considerable goodwill attached to its registered trademarks, which were accepted by the registry. BAA has a commercial responsibility to protect itself against companies using names that might potentially mislead the public into thinking there is an authorised or contractual connection with BAA where none exists.
- 5.3.8 BAA has no objection to Airport Park and Ride companies trading, and BAA similarly does not object to the marks being used legitimately to describe the places to and from which Airport Park and Ride companies operate their services.

- 5.3.9 BAA has advised the Airport Park and Ride companies of the ways in which such car parks may legitimately use these trademark names.
- 5.3.10 In conclusion, BAA considers it is clear that congestion can cause problems on airport forecourts and strives to minimise disruption for passengers and operators at the same time as minimising safety and security hazards. However, with regard to the use of the airport name, BAA has to protect its trademarks, as any company would.

5.4 Car hire arrangements

- 5.4.1 *Complaints were made to the Commission (primarily in the context of the market inquiry) concerning BAA's 'consolidation' of car hire activities and the charges for use of airport facilities, for Heathrow and Gatwick but also other BAA airports.*
- 5.4.2 A consolidated car rental centre is being trialled at Edinburgh Airport in late 2008 following a completely open and transparent tender process. If the trial is successful it may be rolled out to other airports. The centre allows a far more efficient use of scarce airport land as the car rental operators share common services.
- 5.4.3 There will also be a significant reduction in the number of bus journeys transferring passengers to/from the terminal. The shared use of services also reduces barriers to entry for operators which should improve competition in the provision of car rental at airports.
- 5.4.4 BAA accepts not all operators will be keen to sacrifice their independence in this way or welcome further competition. However, in those instances we have been in extensive discussions with the operators to try and mitigate the issues.

5.5 Selection of goods stocked by World Duty Free

- 5.5.1 *The Commission received a complaint that BAA is not prepared to discuss stocking some alcoholic drinks in WDF outlets.*
- 5.5.2 Like most retailers, WDF receive many unsolicited requests to stock new products. The WDF buying team consider these requests based on the expected level of consumer demand and the proposals for marketing support. Many products will not progress to the commercial negotiation stage by failing to satisfy these requirements.

5.6 Use of compulsory purchase order powers

- 5.6.1 *The Commission received a complaint that BAA used its compulsory purchase order powers to acquire land not required for operational use, but for developments which could be undertaken by other companies (including office developments and long-term car parking), and some of which could as a result be subsequently sold at a significant profit.*
- 5.6.2 Since privatisation, BAA has only used CPO powers granted in connection with one project, to acquire land for the development of Terminal 5. CPO powers were approved by the Secretary of State with the T5 planning permission in December 2001.
- 5.6.3 Land acquired compulsorily by BAA is done in accordance with CPO legislation current at the time. This sets out clear guidelines for defining value, as does appropriate case law. Land will be acquired in accordance with CPO procedures, which will include reference to Lands Tribunal for adjudication where necessary.
- 5.6.4 BAA expects to use CPO powers in land assembly for the new runways at both Stansted and at Heathrow in due course. Land will be acquired at the full market value. This does not remove development value where that can be established by the landowner, other than in relation to the scheme underlying the use of CPO powers.
- 5.6.5 All land to be acquired under CPO is required in accordance with the performance of the airport operator's functions as set out in Airports Act 1986. The justification for requiring the use of CPO powers will be submitted with the CPO draft orders, examined at the time of the relevant airport Public Inquiry, and then considered for approval by the relevant Secretary of State.
- 5.6.6 In conclusion, BAA does not concede it has used its compulsory purchase order powers to acquire land not required for operational use, and as outlined above, cannot use its CPO powers without approval by the relevant Secretary of State.

5.7 Poor quality of service and facilities

- 5.7.1 *The Commission received a number of complaints from users about poor quality of service and facilities.*
- 5.7.2 Heathrow ranks 7th out of the 10 broadly comparable hub airports in Europe, and that is far from the position the airport aspires to. However, given the exceptionally congested nature of Heathrow compared to other airports, the ranking is not unexpected. The impact

of the capacity constraints at Heathrow on service levels have been exacerbated by the increased level of security requirements that have been in place since August 2006.

- 5.7.3 To avoid this, Heathrow could have chosen to limit passenger numbers to a much lower level, in line with the design capacity of current terminals. Although allowing the airport to grow beyond its design capacity has negatively affected service levels, BAA does not consider that it would have been in passengers', airlines' or the airport's interests to have limited the capacity of Heathrow to a lower level.
- 5.7.4 BAA is seeking to upgrade Heathrow, and has extensive plans, discussed at length with the airline community through constructive engagement, to transform each terminal in the interests of greater passenger service. This transformation needs to be phased to ensure the continued operation of the airport. T5 is the first element, and once operational, it will effectively create the space that is needed to enable the airport to start the transformation of the other facilities. The Eastern Apron development will commence as soon as T5 opens, and substantial work has been undertaken, and disclosed to the airlines, in preparation for that next step. Equally, the substantial airline moves sequence, and associated upgrades to facilities, has been discussed in great detail, and agreed, with the airline community.
- 5.7.5 During Q4 BAA also commenced an asset refurbishment/replacement programme at Gatwick, which the airport is continuing as an investment priority for Q5. Work currently underway includes:
- passenger sensitive equipment including people movers, escalators, lifts;
 - loading bridges;
 - inter-terminal transit system; and
 - baggage system refurbishment.
- 5.7.6 A project is also underway to increase space and seating in the Gatwick South Terminal departure lounge, opening in phases from Summer 2008, while airline relocations from South to North Terminal (e.g. Continental, Virgin Nigeria) will further ease congestion.
- 5.7.7 In conclusion, BAA does accept that quality of service and facilities could be improved at some of its airports and we are anxious to deliver a higher level of service. However, it needs to be recognised that there are costs associated with this, and the regulatory settlement must enable us to deliver the higher levels of service now being demanded by passengers and airlines.
- 5.7.8 BAA does not consider however that its actions in this area constitute conduct against the public interest.

5.8 Foreign exchange rates charged at the airports.

- 5.8.1 *The Commission have also received a number of complaints from users about the foreign exchange rates charged at the airports.*
- 5.8.2 To the extent that BAA has influence on the rates charged by foreign exchange operators at the airports, it has used that influence to hold charges down. Historically BAA has generally required operators not to exceed the buy and sell rates offered by one high street bank (we refer to this as the Reference Bank), chosen at the option of the operator from the 'big 4 / big 5' on a daily basis. In conjunction with this, BAA has set maximum prices for the fixed amounts of commission charged by bureau operators. In recent years, owing to a move within the UK market place to reduce fixed commission charges and widen the spread between the buy and sell rate, in order to compensate the operators for the corresponding loss in income, BAA has relaxed the rule about having only one Reference Bank, and allowed operators to choose their buy and sell rates from those rates offered by all five high street banks (leading to a widening of the spread).
- 5.8.3 To this end, BAA does not set the rates because it does not control what the high street banks are doing, and because it imposes a maximum to the spread, leaving operators free to choose where they set their rates and hence ensuring competition while keeping rates down. BAA is of the view that these restrictions have held rates down to the benefit of the consumer, and this view is supported by research BAA has commissioned from ESA Market Research most recently in May of this year, which demonstrates that BAA's airports offer a better deal for consumers than Luton, Manchester and Birmingham airports (these were the only competitor airports which were used as part of the study). The results show that the contractual structure we have in place is actually operating to benefit the consumer. We would be happy to share these results with the Commission.
- 5.8.4 A final point to note is that a trial is currently underway to gauge consumer reaction to the establishment of a maximum fixed fee commission (similar to the way foreign exchange is now sold on the high street in the UK) combined with a wider capped spread of rates in place of the existing transaction value based commission with a narrower spread of capped rates.