

13 Views of other interested parties

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Introduction

13.1. This chapter summarizes the evidence we received from other third parties. Hearings were held with eight of the parties.

Concessionaires and licensees

Consignia plc

13.2. Consignia plc (Consignia) said that it was the operator of the Royal Mail's universal postal service. Royal Mail had a statutory duty to provide a letter delivery service to every address in the UK at a uniform price irrespective of the distance. Consignia's parcels business, Parcelforce Worldwide, also made limited use of air transport.

13.3. Consignia emphasized that, although it was a major and frequent user of aircraft facilities, it did not operate its own aircraft fleet but used the services of other operators. In the first instance then, it would be for those operators to comment directly on the effect of any proposed changes. Nevertheless, Consignia would ask the CC to bear in mind that Royal Mail's statutory obligations for provision of a major public service could be affected by any change that impacted adversely on either the time taken to deliver mail to its destination or any charges that added to the costs of providing mail services to the public.

Costa Limited

13.4. Costa Limited (Costa) said that it sold coffee and food at airports and also, in certain locations, alcohol. The Costa unit at Manchester Airport was in T3 near the BA departure gate. It had been there for about four years.

13.5. Costa said that the five-year lease at Manchester Airport was based on a percentage of turnover and with a minimum level based on the previous year's performance. Costa said that its relationship with Manchester Airport was good. The airport did not interfere but endeavoured to help the business to be successful. Costa said that its coffee and food prices at the airport were the same as its prices nationally. It said that the airport environment was open and competitive with various competitors such as Coffee Republic.

13.6. Costa said that it had 27 sites at airports around the country. The level of rent charged at airports as a percentage of turnover was similar to Costa's high street sites.

Dixon Group plc

13.7. Dixon Group plc (Dixons) said that it had shops at Gatwick, Heathrow, Luton, Stansted, Manchester, Birmingham, Glasgow and Edinburgh Airports. Dixons' criteria for opening a unit at an airport was the number of people passing through the airport, their destination in terms of a VAT advantage and the level of the rent. The airport units, generally, tended to sell portable electrical goods and they were most busy between 6 and 8 am.

13.8. Manchester Airport was one of the UK's bigger airports and was therefore attractive to Dixons. Dixons had shops in all three terminals on the airside and had been there for about two years. It had a five-year concession. It said that its rental terms were based on a percentage of revenue relating to each product category. At Manchester Airport there were three different percentages with a minimum guarantee which was set each year.

13.9. Dixons said that its product prices at airports were similar to its high street prices less VAT. It said that it had good working relations with Manchester and no real concerns about service.

The Boots Company PLC

13.10. The Boots Company PLC (Boots) said that generally the customer footfall at airports was the same as in a high street except that the units in airports were smaller. Boots shops were in all airports, or proposed to be, except for the very smallest. Boots provided a core range of products. The cost of a pharmacy was a factor to be considered.

13.11. Boots had four stores including two pharmacies at Manchester Airport and had been there seven years. Boots had no rights of renewal for its airport leases but probably was a retailer of choice. Manchester had details of past takings at the various Boots stores. Under the terms of the leases, the annual rent was calculated as an agreed percentage of that year's takings. At the start of each year, Boots made an advance of 80 per cent of the previous year's rent, with a reconciliation taking place at the end of the year once the amount of the year's takings was known. Boots said that the rent varied at airports according to the size of the airport and the passenger throughput.

13.12. Boots said that there was no significant difference between the rents at Manchester Airport and Manchester city centre although revenue per square foot was higher at the airport. Boots had a good dialogue with Manchester.

WHSmith Retail Limited

13.13. WHSmith Trading Limited (WHSmith) said that it had eight or nine store units at Manchester Airport and was in each of the three terminals. It had been at Manchester Airport for some 30 years, and was currently tendering for a seven-year contract for its sites.

13.14. Manchester required the rental to be based on a percentage of the turnover but with a minimum rental level. Generally the conditions were not onerous and WHSmith's relationship with the airport was excellent. High street units tended to have longer tenure. Sales were on average three times higher at an airport than the usual high street store, but rents at an airport tended to be comparatively higher.

13.15. The profile of airport customers tended to be 25 to 30 years of age, ABC category, 55 per cent male and 45 per cent female. WHSmith said that its preference was for an airport serving scheduled airlines rather than no-frills airlines because of the time travellers had to shop.

13.16. There was plenty of space at Manchester Airport. The airport created the shop shell and WHSmith produced the interior. Alterations to airport premises tended to be more expensive per square foot than the average high street store because the shop specification tended to be higher in airports. WHSmith said that it did not expect much shop space growth at airports over the next five years. The core sales categories were likely to be in steady growth but there might be some greater focus on helping people to fulfil their potential in terms of the books etc on sale.

Company A

13.17. Company A said that Manchester operated in a manner which exploited its monopoly position as the airport authority. Company A said it was recognized by the airports that international car rental companies derived a substantial amount of their revenue from their airport businesses and that they were therefore dependent to a significant degree on their presence at the major airports. Car rental tariffs had remained static in real terms for the last five years. This in turn had resulted in profit margins in the car rental sector being extremely slim (at best) both as a percentage of revenue and as a percentage of investment made. Airports imposed costs and trading conditions which were seldom negotiated effectively because the parties were not on a level playing field as a result of the authorities' monopoly position.

13.18. Company A paid a concession fee to the airport for being present on site at the airport. The amount of the concession fee was calculated as the greater of a percentage of revenue or a minimum annual guarantee. As the fee was strongly influenced by the airport's projections of passenger numbers, both revenue and profitability were dependent upon the projections of passenger numbers issued by the airport. Thus, if passenger numbers fell either because the airport was no longer attracting the forecast volume of passengers or if there was a catastrophic drop in passenger numbers due, for instance, to

global events, Company A was still obliged to meet the minimum annual guarantee. The airport authority should be required to reduce the minimum annual guarantee if its forecast passenger numbers did not materialize.

13.19. An example of a dramatic fall in passenger numbers arose following the terrorist activities on 11 September 2001. It would be appreciated that a fall in passenger numbers would inevitably have a damaging effect on the revenue of operators at the airport, not least because their fixed costs (in particular rents) remained the same. In addition, this inevitably also led to a loss of productivity and efficiency for the operators. Company A argued that there should, in addition, be a requirement upon the airport to also reduce the level of all fixed cost items payable to it. Unless this was done, Manchester Airport would increasingly move its revenue away from the variable items (ie the concession fee) to the non-variable items (for example, rents).

13.20. The definition of revenue upon which the concession fee was calculated was crucial in determining the monetary amount of the fee: the wider the definition, the higher the fee. Manchester imposed its definition without recognition of whether the percentage, applied to any component in the make-up of the revenue, was economic or not. There was no effective negotiation of these components.

13.21. The Vehicle Licence and Registration Fee (VLF) referred to both the road fund licence and the charge imposed by the Government some four years ago to recover the cost of registering vehicles for the first time. The airport did not have regard to the fact that items such as the VLF were charged to customers only to recover the cost of this charge. This fact was not recognized by Manchester which nonetheless imposed the full concession fee rate. All attempts to negotiate this charge as not being within the definition of concessionable revenue had been turned down. Manchester consequently benefited from a wider definition of concessionable revenue.

13.22. The concession fee was expressed as a percentage of revenue. The fee for renewed concession periods was negotiated, but these negotiations were not characterized by the dynamics of normal free market negotiations. Negotiations regarding the concession fee were simply based on what Manchester Airport decided the fee should be. Company A currently paid the greater of a fee of 9.5 per cent of concessionable revenue or the minimum annual guarantee. Company A had no way of knowing whether the fee was fair given the monopoly position of the airport nor what relationship the fee bore to the operating costs of the authority.

13.23. Company A suggested that fees could instead be fixed according to a determination being made after an economic analysis of what the reasonable operating costs of the authority should be, together with an RPI-X formula for any fee increased where X was determined by an external independent body. This should result in requiring the airport to leverage maximum efficiency and ultimately lead to lower operating costs for on-airport operators. This would lead to benefits for customers in the form of lower tariffs and improved service. In addition, such a methodology would consequently require Manchester to maximize the number of passengers using the airport, thereby increasing the revenue of operators.

13.24. As the concession fee payable to Manchester was expressed as a percentage of the operator's revenue, the airport would consequently benefit from becoming more efficient by controlling its costs effectively and through any increase in passenger numbers. Alternatively, the initial fee should be based on Manchester's costs but it should not be allowed to increase the concession fee percentage thereafter. Any increase in its revenue should come from an increase in the operators' revenue.

Ground handling agents

The Go-Ahead Group plc

13.25. The Go-Ahead Group (Go-Ahead) said that it operated at 17 UK airports through its various subsidiaries trading as Aviance. Airports served include all those operated by BAA and also Manchester. It had a number of concerns about the operation of airports and the relationship between the airport operator, the airlines and other service providers, including ground handlers such as Aviance.

13.26. In previous reviews undertaken into airport charges it had been argued that the charges levied by airport operators on ground handling companies were inconsequential in the overall context of airport pricing. Go-Ahead did not agree with this. The charges were of critical importance to ground handlers whose profitability could be significantly impacted by decisions taken by the airport operator. The problem was exacerbated in the current market in which, for a variety of reasons, airlines were unwilling or unable to accept increases in charges levied by ground handlers even though these increases were a direct consequence of charges imposed by the airport operator.

13.27. Airport operators set service standards and allocated facilities which were then applied to ground handlers. For example, SLAs were contracted to the ground handler but the ability of the ground handler to achieve those standards was dependent upon the relationship between the airport and the relevant airline. In a number of cases key aspects of the facilities, which include check-in desks, terminals and parking gates, were negotiated directly between the airline and the airport company but were subsequently licensed to the ground handler. They were therefore paid for by the ground handler leaving the ground handling company exposed to the service standards for the particular airline and ultimately to the debt in the event of default by the airline. This had been an increasing problem in the current market and one which airport operators had been reluctant to acknowledge.

13.28. Go-Ahead said it believed that any inquiry into the conduct of Manchester Airport and the charging structures from 1 April 2003 should include detailed scrutiny of the business relationship between the airport operator and the ground handling companies' business.

National representative bodies

Airport Operators Association

13.29. The Airport Operators Association (AOA) said that it wished to confine its comments to three issues, namely the dual till, security costs and funding for ground transport.

13.30. The AOA noted that the CAA had recommended a move away from the single till as a basis for setting airport charges to a system based on an RRCB, or a dual till. This recognized the economic efficiency of ensuring that airport charges to airlines and passengers were based on the cost of providing the facilities which they actually used, and encouraged a more commercial approach to the provision of airport facilities as a whole. Such a move away from the single till was also consistent with the approach being adopted in other countries such as Australia, as recognized by IATA in recently revised guidelines to member states on the setting of airport charges which noted the move away from the single-till approach. The adoption of a dual-till approach to setting airport charges was of general application and was strongly supported by the airports industry worldwide. The change to a dual till would have wider application to other AOA member airports, which would assist them in developing their commercial approach to business opportunities. Thus the AOA urged the CC to adopt the CAA's broad recommendations in this area.

13.31. Particularly in the aftermath of 11 September, the funding of the costs of the required additional security measures had become a major issue for UK airports. It was clear that in many other countries, particularly the USA but also several in Europe, the costs of additional security measures were being met by member states, albeit that the costs were often passed on to users through taxes or security measures. This was in partial recognition of the fact that the threat was not specific to air transport but was actually a threat to national security. UK airports were concerned that there were no equivalent proposals in the UK and the industry was being expected to fund the cost of additional measures directly.

13.32. It was thus of general concern that the CAA had proposed that BAA and Manchester airports should no longer be able to recover the majority of the costs of additional security measures, imposed by the state, from users via the S factor. This went beyond the UK Government's requirement that the airport paid the cost of additional security measures and recovered the costs from users to an expectation that airports should absorb the costs of additional security measures without any ability to recoup these from users. This further disadvantaged UK airports and set a precedent in relation to the responsibility of airports for funding the costs of additional security measures. The AOA would thus strongly support the continuation of the use of an S factor to allow BAA and Manchester airports to recover much of the cost of additional security measures imposed by the Government, consistent with a view that such costs were not directly related to airport operations but to national security.

13.33. The AOA was aware that the UK Government placed great store on provision of improved surface, particularly public transport, links to UK airports. The AOA had been actively involved in the establishment of government guidelines for the airport transport forums. It was clear that airports and their users would be expected to meet a substantial proportion of the costs of the provision of improved links over time. The AOA had noted with some concern that the CAA had proposed that at the regulated airports such costs would not be included in the RRCB unless expressly required as a result of planning approval to a development proposal. This appeared to be directly contrary to the Government's intention to actively encourage airports to invest in public and other transport initiatives. Such investments were necessary to increase the proportion of passengers accessing airports by public transport, regardless of proposals for increasing airport capacity under the planning system. In many cases, such initiatives would not be commercially viable and, furthermore, funding would also need to recognize the extent to which there were wider network benefits to be obtained from the investment in improved transport links serving airports, as part of the urban infrastructure. The beneficiaries of such links would be the airlines, as it would be easier for passengers to access the airport by all modes, the passengers themselves and the wider community. Airports would seldom benefit directly from such links, particularly if they were not able to recover the costs through airport charges.

13.34. The AOA was concerned to ensure that its members were incentivized to invest in public and other transport links, consistent with the Government's policy objectives. Furthermore, the AOA supported the view that airlines and passengers benefited directly from investment in improved transport to airlines, regardless of whether they used such links directly. It was unrealistic to expect that such improved links would be funded entirely by the state or wider local and regional transport interests, as the CAA suggested as an alternative. The AOA thus supported the inclusion of the costs of ground transport links funded by airports, within the RRCB, regardless of whether they arose as a direct planning condition or not. To do otherwise would result in a failure to invest, with consequent damage to the interests of users and the wider community.

Air Transport Users Council

13.35. The Air Transport Users Council (AUC), commenting on both Manchester and BAA airports, said that it had sought to identify where the consumer interest lay in the economic regulation of airports. It had accepted that changes in the price cap had little discernible impact on fares (not least because the per passenger charge to airlines from regulated airport charges reflected only a small proportion of the cost of providing the service) and had therefore sought to establish passengers' requirements at airports and to consider whether the regulatory regime might more effectively influence airports to meet those requirements. The AUC had concluded that the passenger interest lay principally in the timely investment in additional facilities at the airports in line with increasing demand.

13.36. The CAA's statutory duties included the encouragement of investment. The AUC welcomed the CAA's ongoing examination of whether the regime could be modified to pursue this goal more effectively. The AUC felt that the current process appeared to be leading to a regime more closely tailored to passenger interests than those of the past.

13.37. The proposed move from single till to the RRCB would be a fundamental change in approach as seen from the perspectives of the airlines and the airports. A key issue for the AUC was whether there was any consumer interest in which of the parties—airlines or airports—enjoyed the benefit of the economic rent arising from scarce capacity at Heathrow. The AUC view was that if the greater proportion passed to the airports, and if the airports could be influenced to invest the rent in additional facilities, then a transfer from airlines to airports must be in the interest of consumers. The AUC noted the CAA's caution that it had no powers to force airports to undertake capital expenditure, but was encouraged by the incentives for it to do what the CAA was proposing. The threat of a return to the single till in future reviews if they failed to invest would no doubt provide further encouragement.

13.38. The AUC appreciated the arguments against imposing service quality standards at Stansted and Manchester for 2003 to 2008. However, the inclusion for these airports would be consistent with the reasoning behind the CAA's cautious approach to introduction of service quality terms for Heathrow and Gatwick. The proposals started from a modest base, leaving open the possibility of modification in sub-

sequent reviews. For Stansted and Manchester, current conditions might not appear to warrant such a service quality term. But this might not be the case at the time of the next review. There may therefore be merit in introducing a term this time round. This would go some way towards ensuring the maintenance of minimum standards during the 2003 to 2008 period. And if, at the time of future reviews, more rigorous service quality terms were considered necessary, the principle would have been tried and tested in application.

13.39. It was not clear to what extent, if any, the objectives of Manchester Airport's local authority owners impacted differently in practice on consumers from the objectives of BAA. Passengers using the airport outside peak times possibly enjoyed more comfortable terminal facilities than at an airport where investment was planned solely according to commercial imperatives. Conversely, it might appear that higher charges needed to fund the investment might deter some airlines (notably low-cost carriers) from increasing the range of destinations and fares available for Manchester passengers. However, as the CAA noted by reference to the airport's Millennium Discount scheme and to other initiatives for attracting new airlines, this did not generally appear to be the case. It therefore seemed that consumer interests were sufficiently taken care of within the CAA's philosophy of provision of 'high-level protection' for users of the airport.

13.40. The AUC responses to earlier consultations had supported CAA proposals to encourage contracting between airports and airlines, with the caveat that any such contracting should be underpinned by a default price cap associated with minimum levels of service. The AUC noted the CAA comment that this implied a real increase in prices charged to airlines, but would not see this as a potential dis-benefit to consumers. On the contrary, there was a clear indication that the CAA would encourage ring-fencing of revenues from higher charges for future investment. This could only be to the benefit of consumers.

13.41. The principal concern of the AUC in respect of regulation of airport charges was that the regime should encourage the timely investment in additional facilities to meet growing demand. In the context of the limited powers of the CAA, it could be argued that some of the latest proposals for encouraging new investment implied an element of risk in that their success depended on the good faith of the airports. The AUC considered that the measures proposed by the CAA not only considerably reduced any risks to passenger interests from the changes, but also offered considerable long-term advantages for consumers in terms both of timely investment in new facilities and of overall levels of service.

British Airline Pilots Association

13.42. The British Airline Pilots Association (BALPA) said that airlines, which faced a difficult cost environment, should not be penalized by the abolition of the single-till approach. The single-till method kept charges at a reasonable level for airlines, ensuring that they shared in the revenues which their presence also generated, notably shopping, car parking, property rental etc. Whilst agreeing with the CAA that alternative measures could be found to distribute these costs and revenues, the single-till approach had worked well, and other methods would be less efficient. Any move towards a dual-till approach would lead to the airports reaping monopoly profits to an unacceptable extent, and would be directly harmful to the future of airlines, and indirectly would penalize passengers.

13.43. BALPA welcomed the CAA's recommendation that the three London airports and Manchester Airport should be treated separately with the elimination of cross-subsidies and with the requirement to set separate price caps. It also welcomed the introduction of service quality standards and penalties for failure to meet these targets. However, the issue of capacity needed to be considered as many service delays were due to congested airspace. BALPA would be concerned if pressure were put on the air traffic control system to deliver such benefits. It would urge caution, however, on punctuality targets and suggested that such targets should relate only to delays and failures wholly attributable to the airport operator. The airport air traffic control interface had to be taken into account in this regard.

13.44. BALPA agreed on the need for improved consultation with airlines on capital spending plans to ensure that adequate resources were channelled into capacity and infrastructure enhancement. These

questions could not be divorced from the wider question of capacity and infrastructure and that whilst scarce and valued resources should be regulated, especially where monopoly power was evident, the best solution overall was to allow more capacity to be provided.

The Association of British Travel Agents Ltd

13.45. The Association of British Travel Agents Ltd (ABTA) said that it represented the interests of over 1,700 travel agents trading out of some 6,800 high street outlets and 800 tour operators who, between them, accounted for well over 90 per cent of the air holidays and 80 per cent of the air tickets sold in the UK. Members were part of groups themselves owning airlines. Changes in charges and other aspects impacted significantly upon the costs of air travel and package holidays sold by its members.

13.46. ABTA said that it could not support the CAA's recommendation to move from the current single till to a dual till or RRCB, and suggested that there was no evidence to suggest that investment had been inhibited as a result of the single till. Any delays to airport infrastructure had been due to political rather than economic considerations. A move to an RRCB was acknowledged by the CAA to result in higher prices. These could not be absorbed by the airlines and would have to be passed on to the travelling public. ABTA wondered whether the CAA had adequately considered the external constraints on investment to meet the demand on capacity other than opting for a radical move away from single till.

13.47. ABTA said that it was not in favour of prefunding and felt that services should be paid for as they were received. ABTA considered that the work undertaken on quality of service issues should be developed. SLAs were important and should be introduced with the airports being made accountable for their delivery along with financial penalties.

Shareholders of MA

Manchester City Council and the nine other Greater Manchester local authorities

13.48. Manchester City Council said that its response was in its capacity as shareholder in MAG. MA was a wholly-owned subsidiary of the Group company. The CC hearings were attended by representatives of Manchester City Council and two representatives from the other shareholders. Together they put forward the shareholders' views.

13.49. The shareholders' primary concern was to ensure the continued profitable growth of MA, and to realize the benefit of the investment in extended infrastructure, including in particular a second runway, to which the shareholders had committed in recent years. The priorities for growth included continuing to meet the demand for leisure travel arising in MA's catchment area, to extend the network of scheduled European destinations served directly from Manchester, and to increase access to long-haul destinations by extending links to long-haul hubs, particularly in the USA.

13.50. The achievement of these growth objectives was reflected in an increase in projected traffic numbers to 29.12 million in 2010/11, which was broadly in line with the national projections for regional airports over the same period. The shareholders did not believe that this growth would be easily won, and in the past year they had therefore put in place a number of initiatives which were intended to create the right conditions for growth. These initiatives had been directed to two concerns. The first was the need to ensure that, as the business had increased in size and complexity, accountability to the shareholders was maintained, and that management effort was properly focused on, and measurable against, shareholder objectives. This requirement led to the restructuring commenced in 2001 and which was now nearing completion.

13.51. The second driver was the need for competitiveness, to which end the shareholders instigated a thorough assessment of the airport's current market position, as the basis for developing a new long-term business strategy. The shareholders understood the CAA's argument that MA's market share represented monopoly power, but contended that MA was operating in a fiercely competitive environment, and that it was the competition, not only between airports but also between airlines, which would drive

business priorities and decisions over the coming years. Specifically, the shareholders noted the growth in passenger numbers at neighbouring airports, which was adversely affecting MA's market share. More importantly there was increasing evidence that the expansion of low-cost carriers was providing a spur to radical change throughout the airline industry. This was manifest in intense downward pressures on airline costs and fares, pressure which extended to airport charges, and in increasing demand from airlines for differentiation in airport products.

13.52. The shareholders' priorities were to realign relationships with key customers into focused partnerships, with clearly specified targets and outputs; to reduce MA's cost base, reflecting the need to reduce charges to airlines and to improve competitiveness; through the reorganization, to gain much tighter control over the costs and outputs (including service quality) of MA's service contracts with internal and third party suppliers; and to improve capital investment decision-making, so that investments were timely, relevant, and fully cost-effective.

13.53. The shareholders welcomed the CAA's general proposition that the burden of regulation should be lightened, and that the focus of regulation should be narrowed to the core monopoly aeronautical activities. The move to an RRCB methodology and the proposal for a looser price cap were important steps which would allow MA to demonstrate that its decisions were elective and market driven, rather than enforced by a tight price cap and distortive, expensive regulatory controls.

13.54. The shareholders were concerned that the CAA's logic in applying the RRCB approach to Manchester as well as to BAA rested in part on the suggestion that MA's owners were less concerned than private shareholders would be with maximizing profitability. It was correct to say, they said, that the shareholders had a strong focus on growth, and to that extent had a natural incentive to ensure that necessary investments to facilitate growth were made. But the true emphasis was on profitable growth, and the evidence to support the CAA's proposed shift to RRCB-based regulation lay in the shareholders' view that reduced costs and customer focus were critical to the delivery of this growth, simply because anything else would not be competitive. The shareholders had no specific observation to make on the price control formula, other than to note that the continuing uncertainty about the timing of recovery from the events of 11 September made it essential that the proposals remained tentative at this stage, and that they might wish to comment further at a later stage in the review process.

13.55. There were two specific aspects of the CAA reference document with which the shareholders disagreed. These were the proposal to exclude surface access assets from the RAB, and the proposed termination of the automatic pass-through of increases in security costs. Both of these steps appeared singularly at odds with the thrust of public opinion and public policy at the present time.

13.56. In the case of surface access, the shareholders were surprised by the rigidity of the suggestion that the costs of ground transport infrastructure should be borne wholly by MA, other than when specifically required as a condition of planning consent for facilities which were aeronautically essential. A critical and valuable part of the planning process was the ability to resolve the concerns of potential objectors through voluntary agreements like the section 106 agreement which MA entered into with Cheshire Council prior to the R2 inquiry process. The effect of the CAA's proposal could be to discourage MA from such voluntary solutions, unnecessarily prolonging the formal planning process and placing its outcome in jeopardy. Furthermore, the shareholders disputed the implication that surface access was not part of the essential infrastructure supporting the aeronautical operation. Indeed, as environmental issues became central to the debate about the growth in air travel, it was highly likely that the 'price' of meeting demand would be increased investment in public transport infrastructure in particular.

13.57. The proposed ending of the S factor mechanism was surprising. In the first place, unanticipated security costs arising during the course of a quinquennium were likely to be, if not inevitably, the result of regulatory decisions over which MA had no control, and it was difficult to see the logic behind the suggestion that the burden of such additional costs should be borne by MA alone. Second, the possibility of such unpredictable regulatory intervention was likely to have increased since 11 September, and MA would be acting prudently to seek to make contingency provision against the potential costs.

Tameside Metropolitan Borough

13.58. Tameside Metropolitan Borough said that it agreed with the response of the major shareholder, Manchester City Council.

Wigan Council

13.59. Wigan Council's views were the same as those set out by Manchester City Council on behalf of the ten Greater Manchester local authorities in their capacity as shareholders in the MAG.

Other local authorities

Borough of Macclesfield

13.60. The Borough of Macclesfield (the Borough) said that it would not like to specify a maximum level of airport charges but would like to stress that airport charges should relate to the level of demand at the airport, as it was currently illogical for airlines using the busiest airports to be paying lower charges and thus inflating demand. The Borough said that it supported the CAA proposals which sought to overturn this anomaly, particularly the dual-till principle. However, it considered that the scope of those items included in the charges was too narrow. The regulatory regime should allow for the airports to include surface assess/public transport requirements in the charges. Failure to do so might result in an excessive burden on the local authorities in the area surrounding the airport.

13.61. The Borough had contributed to SASIG's response to the CAA's consultation on airport charges. The Borough drew attention to the proposal for local authorities as well as airport users to benefit from improved information disclosure. One aspect of Manchester Airport's charging policy which the Council strongly supported was the fines levied on aircraft exceeding noise parameters—the funds from which went to support community projects in affected communities.

Chester City Council

13.62. Chester City Council said that the vitality and expansion of Manchester Airport was critical to Chester's economic competitiveness. Chester was an international tourist destination for overseas visitors, and having Manchester Airport close by was important. It was also well used by Chester's business community, as it had a number of UK and international businesses which required air transport.

13.63. Chester City Council said that it did not feel able to comment on Manchester Airport's charges and whether the airport had undertaken any actions which were against the public interest.

Trade unions

Transport and General Workers' Union

13.64. T&G said that the dispute at Manchester Airport was about reducing the terms and conditions of security and other staff and was planned before 11 September. In June 2001 Manchester announced that it was restructuring its business from a single company to a group company with five trading company subsidiaries to focus its activities and reflect its growing role as the second biggest airport group in the UK. The company stated that by forming a group structure and setting up new corporate governance arrangements it would enable the group to take advantage of the enormous growth potential for aviation in the UK and, in particular, for regional airports. In fact, this amounted to Manchester establishing two divisions, with separate Managing Directors, so that it could create an internal market. The reason for creating the internal market was to subject the security and other functions to external market forces, with the foreseen consequences of job losses and the reduction of terms and conditions of employment of those remaining as employees of Manchester Airport.

13.65. On 2 October 2000 Manchester announced a restructuring, as part of a refocusing of its activities that it claimed would put customer service, quality and passenger safety at the heart of its business. The changes would result in the airport making more efficient use of its resources in the highly competitive aviation industry. As part of this refocusing, up to 90 jobs would be lost in its management, operational and administration area, with some functions being combined to achieve efficiencies. Manchester began to implement job cuts on the information desks and elsewhere. The T&G had to threaten

Manchester with legal action before it consulted properly with the T&G. Manchester also ignored its existing 'no compulsory redundancy' policies. This was resolved because there were enough volunteers to avoid a dispute.

13.66. The company's next step was to announce the establishment of a 'new' security company (MAAS)—a wholly-owned subsidiary—that would tender for work competitively at the airport. Staff would receive significantly lower pay and poorer conditions than the existing security staff. Unsurprisingly, MAAS won the contract to provide security work for T3.

13.67. The T&G said it was deplorable that 140 security posts were to be phased out and pay for all other security staff reduced to around £5.50 an hour. In a bid to slash Manchester's £17 million annual security budget, staffing levels would be reduced from around 700 to 560 and top-earning security guards offered new contracts that would cut their salaries by more than half. Workers on up to £28,000 a year were being offered voluntary redundancy worth £11,545 to £12,622.

13.68. The company proposed that their working week should be increased from 38 to 42 hours, annual holidays cut by four days, and sick leave entitlement halved. It said that the rate of pay remained higher than private security firms employed at other airports and it would continue to meet all the stringent standards demanded by the Government. New recruits would earn the same money as existing employees. The proposals caused major internal strife at a time when 1,800 workers, including security guards, were being balloted regarding a strike relating to 90 earlier redundancies mainly affecting clerical staff.

13.69. The T&G had consistently warned that the airport had planned to take on a smaller number of new staff on poorer pay than existing security guards, and if implemented this would undermine the morale and efficiency of the workforce and threaten security at the airport. Manchester claimed that the job cuts would allow it to change shift rosters that currently caused wasteful working practices. However, there would be no reduction in the number of security staff on duty, and the same stringent security standards would remain in force.

13.70. The T&G said that the reason for these proposals had been stated in a letter to Manchester staff dated 16 January 2002 from John Donnison, Business Manager, Fire & Security Services: 'the need for the security business at Manchester Airport to become more competitive with external security providers ... and terms and conditions of employment which far exceeded what the competitive market will accept'. Manchester had also said that the changes were designed to ensure that the airport became more competitive so it could attract airlines such as easyJet, which operated out of Liverpool.

13.71. The T&G said that Manchester had not learned the lessons from across the Atlantic about reducing labour costs of the security function. It said that ideally all airport security staff should be employed by the airport. The wages should reflect the skill and responsibility of the job, not the lowest price some company was prepared to bid for the contract. The T&G said that its members recognized that the airport might suffer as a consequence of the current difficulties in aviation, so they took the position that it would be supportive. They decided that they would defer their annual pay rise of 2.5 per cent for up to one year. They also felt that the nine local authorities should accept a similar 2.5 per cent cut in their dividend for the same reason.

13.72. The T&G said that the cuts in security jobs meant that 590 workers had been told:

- to take a pay cut of 40 per cent or be sacked;
- to increase their working week from 38 to 42 hours; and
- to reduce their holidays from 27 days to 20 days per year.

The reasons for these job losses were solely to increase the profitability of MA and did not add value to the provision of the security function at the airport. As a responsible trade union the T&G took the view that the actions taken at Manchester were the worst kind of corporate greed, and that the reduced level of the terms and conditions of security staff would affect the professionalism and quality of people working at the airport and would eventually impact on the travelling public. This had been brought about by a change in the corporate culture. The T&G believed that MA was now driven by profit and that the CAA should revisit the issue.

Others

Adam Smith Institute

13.73. The Adam Smith Institute (the Institute) said that it believed the problem of competition in airports allied to the provision of additional capacity, particularly in the South-East of England, was caused primarily by the way the industry in the South-East of England was privatized as a monopoly. It was the regulation of this monopoly which was inefficient and did not provide the incentives either to develop capacity or to provide the equitable charging policy for the users in line with market demand.

13.74. The Institute said that the nature of demand for aviation services was effectively limitless. There were no social issues involved in airports, which would normally be expected to distort the market. Every passenger who flew and everyone who worked at an airport paid a fair price or was paid a fair wage. Business travellers had shown that they were used to paying significantly more than leisure passengers for their flights. Thus the impact of increased traffic would primarily affect the leisure traveller and not have a major impact on the economy. It was a classic case for market forces to be allowed to control the overall increase in activities of the aviation sector. The Government should stop worrying about the capacity of the system, as this should be provided by the market. It should, rather, concern itself with the definition of environmental standards and recompensing the community, together with establishing the security and safety standards which airports were required to meet.

13.75. The Institute said that by privatizing a public monopoly and changing it to a private monopoly the disciplines of competition were replaced by those of regulation. The Institute believed that the regulating authority had not applied its powers sufficiently to turn the private monopoly into a competing airport system. At a simple level this could be done by encouraging the separating out of the individual airport ownerships and at a more complex level by the separating out of the terminal ownership or even gate ownership within the major airports. Either of these courses would increase the competition element and hence reduce the regulatory requirements of the current system. The Institute believed that the CC should expand its existing brief to consider this aspect.

13.76. The Institute said that the other element which could distort the picture, unless it was dealt with in an even-handed manner at Government level, was the environmental impact. Every airport in the UK should therefore be subject to the same defined environmental standards as laid down by the Government. The New Towns policy developed by previous governments to overcome the environmental impact on existing countryside of major new developments would serve as a model. Individuals or communities should be compensated on an agreed basis when the environmental standards exceeded the government standards.

13.77. A similar position arose with security. Security and safety should not form part of the competitive environment. Security standards should be laid down, supervised and approved by the Government, if necessary licensing airports for appropriate traffic. Airports should be able to reimburse their costs for these services from passenger charges on a non-profit-making basis.

13.78. Because of the organization of the industry, the Institute believed it was inevitable that neither the airport nor the regulator could accurately determine the public interest in the same way as market forces were able to do. The Institute urged the CC to review the ownership patterns and how these might be devolved into a competing system. The Institute recognized that it was unlikely that the South-East of England, for example, would ever produce a system of perfect competition as the number of runways would always be limited by environmental pressures. Therefore, the limited regulation of runways, aprons and taxiways would always be required. This should be cost based with air traffic charges being used as a model with the costs including a structured element of environmental compensation, either to individuals or the community.

13.79. With regard to airport charges, the Institute considered that the regulator should not be concerned regarding the individual charges once true competitive forces were established off the runway. It should concern itself with the costs against which these charges on the runway might be calculated and which the airport would seek to recover from the airlines. The costs against which the charges should be arrived at should cover the following aspects:

- (a) the operating costs of the runway, aprons and taxiways including fire and rescue, air traffic control, maintenance etc;

- (b) the depreciation of the runway and the upgrading and improvement works necessary for the runways, aprons and taxiways;
- (c) the environmental costs based on the environmental impact of the runway on the adjacent community or individuals concerned; and
- (d) a security charge based on the actual costs of providing the appropriate level of security should be levied on a per passenger basis.

Charges for use of terminals, gates etc would be subject to competition and therefore remain unregulated.

13.80. This approach might not be suitable in other parts of the country including Manchester, for example, where competing airports at Liverpool, Leeds Bradford and Finningley could be expected to provide increasing competition as markets develop. The way in which Manchester was acquiring other airports would inevitably affect this scenario, particularly as it appears not primarily motivated by profitability. The limits of competition should be defined by the CC in the light of the ownership patterns.

First Choice Holidays PLC

13.81. First Choice Holidays PLC said that its views were communicated to the CC under cover of a letter from Monarch Airlines on behalf of the Charter Group of which First Choice's wholly-owned subsidiary, Air 2000, was a member.

Mrs Beryl Hatton

13.82. Mrs Beryl Hatton said that she would like to comment regarding landing fees and charges made to airlines at Manchester Airport.

13.83. Mrs Hatton said that she lived within easy reach of Manchester Airport and used it frequently for holiday travel. It was therefore infuriating not to have access to cheaper no-frills airlines such as easyJet or Go because the landing fees and charges at Manchester were apparently too high for them to operate profitably. They therefore flew out of Liverpool or Stansted, which was not convenient for people who lived within the Manchester Airport catchment area.

13.84. A great deal of money had been spent on Manchester Airport but it had not benefited passengers' wallets. Mrs Hatton said that she had often flown out of Gatwick and Heathrow and found that the competition within those airports offered the passenger a better deal than at Manchester.

Mr David Starkie

13.85. Mr David Starkie (Economics-Plus Limited) said that the pricing formula used to constrain charges at designated airports usually applied to airport charges as a whole (although there were exceptions such as the modified formula used in relation to non-passenger flights at Manchester). The airport company had freedom, therefore, to structure charges within the overall price cap; this was considered desirable because it minimized regulatory intervention. However, it was important to recognize that the issue of price structures could not be separated from capex requirements. An inefficient structure of prices could lead to increasing pressures on capacity and, therefore, accelerate requirements for additional, but not necessarily justified, trenches of capacity. The relationship between the structure of prices, the size of the capex programme and, consequently, the overall level of the price cap, could be critical and perhaps this relationship had not been given the attention it deserved in previous price-cap reviews.

13.86. In the light of this relationship between the size of the capex and the level and structure of prices, there might be a case for refocusing the regulatory approach, placing less emphasis on the overall level of the price cap and rather more on the structure of charges. One reason for doing so was that airports had an interest in airport retailing and property as well as providing aeronautical services. Increase

in traffic volumes increased the profitability of the non-aeronautical but complementary activities and provided an incentive for the airport operator to increase airside output beyond the point where marginal revenues from aeronautical charges cover airside marginal costs: the airport business was unlikely to maximize overall profits if it sought to maximize net revenue from charges alone. Consequently, in the absence of a price cap (or with a generous price cap), the profit-maximizing airport was less likely to abuse its market power by setting too high a level of charge. Second, because price caps were set with reference to an allowable rate of return on assets, the price-capped firm had an incentive to expand its RAB providing that the enlarged RAB met, in aggregate, the company's overall costs of capital. There were, therefore, incentives for the airport company (profit-maximizing but price capped) to invest inefficiently. This, in turn, could encourage the inefficient pricing of, and thus inefficient use of, existing capacity.

13.87. Manchester, however, did not have a singular objective of seeking to maximize profits but it pursued a wider set of objectives. It was therefore a moot point whether it had the same incentives as, say, BAA to maximize the contributions of non-aeronautical activities to the revenue pot, although it was possible that the diverse objectives that Manchester pursued provided some incentive for it to moderate its overall level of charge. On the other hand, the pursuit of objectives other than maximizing profits appeared to encourage the price-capped airport to overexpand capacity. Manchester invested to meet unconstrained demand so that investment was primarily to add capacity at peak times in spite of much spare capacity in the off-peak. As a result, in the longer term, users were likely, on average, to pay higher charges but, because of the long-term nature of this impact, it was unlikely to be evident to them. It was important, therefore, that Manchester adopted efficient pricing structure to encourage the better use of existing capacity, if the long-term interest of users was to be served.

13.88. Mr Starkie said that in the MMC's 1987 report, it encouraged Manchester to take into account the pressures which peak demand placed on the company's expansion programme and suggested that it adopted a charging structure with greater differentiation between peak and off-peak charges. In the MMC's 1992 report the MMC repeated these concerns and recommended that the airport adopt a cost-related charging structure. In spite of these recommended by the MMC and notwithstanding the introduction of a charging schedule from April 2002 incorporating some off-peak discount, the 'CAA believes that there is considerable scope for improving airport capacity [at Manchester] through price differentiation'. (Recommendations to the CC, February 2002.)

13.89. Recent developments in Ireland suggested one possible approach to this problem. In 2001, a Commission for Aviation was established to regulate charges at the three main airports in Ireland. An overall price cap was introduced for these three airports but in addition, for Dublin, a moderately congested airport, the Commission also specified maximum charges for the use of runways during the off-peak. Off-peak charges were based on damage/wear-and-tear costs; these were judged to be the marginal costs of using the runway/taxiway infrastructure at off-peak times. Because of the de minimis nature of these costs, it was anticipated by the Commission that the airport operator would fix charges during peak period at a much higher level, and this has occurred. The short-run marginal costs that form the basis of off-peak charges was easier to identify and calculate than the costs pertaining to the peak and therefore this approach provided a pragmatic and yet economically efficient way of introducing significant charging differentials.

13.90. To summarize: inefficient pricing of existing capacity could result in pressures to add capacity and, because of the importance of capex in determining the level of the price cap, inefficient pricing could lead to unnecessarily high levels of average charge. Because of this, Mr Starkie said he would argue that relatively more attention should be given to price structures in periodic reviews. This conclusion was supported by the incentives that profit-maximizing airports with spare capacity, have to moderate charges by developing commercial revenues; but the existence of a price cap provided an incentive for the airport company to overexpand the RAB. This, in turn, reduced the incentives to adopt an efficient structure of charges with peak/off-peak differentials. Manchester's pursuit of diverse objectives might exaggerate this reduced incentive to act efficiently and the airport had not adopted peak period pricing in response to firm recommendations by the MMC that it do so. Although Manchester was not at present significantly capacity constrained, the CAA was of the view that 'there is considerable scope for improving airport capacity [at Manchester] through price differentiation'.

13.91. Mr Starkie said that in the light of these circumstances, and given the peaked nature of current demand, Manchester should be required to introduce at the earliest opportunity a cost-based pricing

regime with a pronounced differential between peak and off-peak use. Such a regime could be put into effect relatively quickly by calculating the (short-run) marginal costs of off-peak use following the approach undertaken by the Irish Commission for Aviation Regulation for Dublin Airport. In view of the relative neglect of the MMC's previous recommendations on this issue, the CC should consider the case for a public interest finding.

Professor Stephen Littlechild

13.92. Professor Stephen Littlechild copied his submission on the BAA London Airports inquiry to the Manchester Airport inquiry.

Manchester Chamber of Commerce and Industry

13.93. Manchester Chamber of Commerce and Industry said that Manchester Airport was a member of Manchester Chamber and its former Chief Executive, Geoff Muirhead (now Chief Executive of MAG), was a Past President of Manchester Chamber. Manchester Airport served as a world-class gateway to the North-West and was a major contributor to the region's economy. Over recent years, the airport had increased its capacity in order to allow ambitious targets to be met in numbers of passengers, improved access and jobs created. It was critical that the region's airport remained competitive for passengers, airlines and other service providers. The impact of 11 September had exacerbated the economic slowdown of the North-West, where a significant proportion of employers were in the manufacturing sector, which was already in recession. Given that the prediction of an economic upturn was difficult to judge, a pessimistic forecast of passenger numbers post-11 September was understandable.

Peel Airports Limited

13.94. Peel Airports Limited (Peel Airports) said that Liverpool John Lennon Airport (which was owned by Peel Airports) was situated 35 miles west of Manchester Airport and offered complementary services. While Manchester focused on the international scheduled gateway segment of the scheduled services market, Liverpool was successfully making an entry into the low-cost scheduled market segment. Peel Airports believed that it was in the North-West's interests if each airport were able to develop in these segments in order that the region could face the inevitable competition from other regions, particularly in mainland Europe.

13.95. Liverpool was also the aspiring competitor to Manchester in that, for the first time, north-west consumers were beginning to have a choice between market segments and between airports. The issue of the pricing formula and mechanism to be adopted for Manchester was, therefore, an important issue for Liverpool, as any restriction placed upon Manchester would act as an artificial restriction to the competition that was beginning to appear.

13.96. Peel Airports said its concern was that any excessive pricing restriction imposed on Manchester would result in less competition. In such circumstances, Liverpool would be less able to fulfil its strategy of strengthening its position as the leading low-cost airport for the region. If it could fulfil this goal, then competition would be safeguarded and enhanced. If not, Manchester's dominance would increase.

13.97. Peel Airports urged the CC to avoid imposing an onerous pricing cap on Manchester as this would at best further competition between the airports. Peel Airports believed that the dual-till arrangement was more suited to nurturing potential competition and improving customer choice, rather than the single-till approach.

Tangney Tours

13.98. Tangney Tours said that it would like to bring to the CC's attention a hidden cost being charged by the airports. This was a direct tax being levied against the handicapped traveller. Tangney

Tours said that the handling and assistance of handicapped travellers at Manchester Airport had been outsourced to private contractors. These contractors made a charge to the airlines for the handling and assistance of every handicapped traveller. The airline then reserved the right to pass on these charges directly to the purchaser of the air seat.

13.99. Tangney Tours said that in order to avoid discrimination to the handicapped traveller, these additional costs should be absorbed and the price charged should be the same for all travellers using the airport facilities.

P A GEROSKI (*Chairman*)

S E BROWN

L ELKS

A GREGORY

J D S STARK

R FOSTER (*Secretary*)

25 October 2002