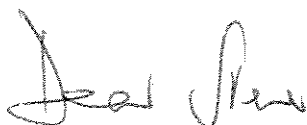


Steve Ronald
Chairman
LACC Heathrow
Waterside (HBA1)
PO Box 365
Harmondsworth
UB7 0GB

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Competition Commission market investigation into BAA Ltd: CAA response to the Commission's recommendations on the information protocol

The Competition Commission (CC) published its report on the supply of airport services by BAA (the CC's Final Report) on 19 March 2009. As part of the package of remedies, the CC made three recommendations to the CAA relating to the regulation of BAA's conduct at Heathrow.

This letter sets out the CAA's proposals for a way forward in respect of these recommendations. This letter is structured in two main sections. The first provides a summary of the CC's recommendations and the second sets out the CAA's proposed response to these recommendations.

The CAA has discussed the proposed way forward with the CC.

The CC's recommendations to the CAA

The CC made recommendations to the CAA in two areas: the information protocol at Heathrow; and the frequency of audits of the Service Quality Rebate (SQR) scheme.

In respect of the first, the CC recommends that the CAA brings forward its planned review of BAA's performance on consultation. In addition, the CC recommends that the airport operator and airlines should enter into discussions with a view to agreeing an updated information protocol for Heathrow, building on the existing 'Annex G' agreement. This updated information protocol would take into account the differences between it and the information protocol recommended by the CC for Stansted.

The protocol would also be extended to cover the sharing of information relating to BAA entering into any agreement with one airline, or a group of airlines, that may have a

significant effect on the competitive position of other airlines. The CC set out its views on what this protocol might contain in Appendix 10.9 of the Final Report, which included its view that BAA should be obliged to secure the agreement of all of the affected airlines and commit to formal dispute resolution processes in the event that agreement cannot be secured.

In respect of the second area – the frequency of SQR audits – the CC recommends that independent audits should be undertaken on an annual basis at Heathrow.

The CAA's proposed way forward

Having considered the CC's Final Report, the CAA proposes the following way forward in respect of the review of Heathrow Airport Limited's (HAL) consultation performance, any update to the information protocol and the frequency of service quality audits.

The review of BAA's performance on consultation at Heathrow

The CAA implemented the existing Heathrow information protocol as part of its March 2008 decision on the Q5 price control, following extensive consultation and having regard to the CC's September 2007 recommendations.

As part of this decision, the CAA stated that it would undertake a 'mid-quinquennium' review of both capital investment efficiency and HAL's performance on consultation. The purpose of this review would be to provide: greater evidence to inform the Q6 price control review; a mid-term progress report on HAL's consultation performance; and pointers for improvements which HAL and the airlines might make during the remainder of Q5¹.

The CAA considered the issue of the appropriate timing of the mid-quinquennial review when reaching its price control decision and has now considered whether there is a case for modifying this timetable in light of the arguments put forward by the CC. The original timetable allows for consultation on the precise scope of the review and ensures at least two years of data will be available to inform the review. The CAA also notes that the scope of the CAA's mid-quinquennium review is much broader than the CC envisages for the information protocol. In these circumstances, the CAA considers that it would be best clearly to distinguish between a process to revise – by airport-airline negotiation – the content of the information protocol and a CAA-led review on HAL's compliance with the prevailing protocol (together with HAL's performance on capital efficiency).

For these reasons the CAA considers that the timetable for its work programme should remain as set out in its March 2008 decision, namely that:

- Summer 2009: CAA consults on scope of the mid-quinquennium review
- April 2010: review commences
- By December 2010: review reports

Extending the information protocol at Heathrow

The Heathrow information protocol is as set out in Annex G of the CAA's March 2008 decision. However, HAL and the airlines could, at any time, negotiate and agree changes to this information protocol, including considering whether and how the Heathrow protocol could be updated in light of the information protocol put in place at Stansted in March 2009.

¹ Chapter 8, 'Economic regulation of Heathrow and Gatwick airports 2008-2013 – CAA decision', CAA, March 2008.

In addition, HAL and the airlines could consider whether the information protocol should be extended to cover the sharing of information relating to the airport operator entering into any agreements that may have a significant effect on the competitive position of airlines.

To the extent that HAL and the airlines reach agreement on an updated information protocol the CAA would expect to adopt this agreed protocol and to use it to assess HAL's performance at the Q6 review².

To support this process, the CAA will make available a third-party facilitator to assist with either the negotiation of a new information protocol and/or the implementation of any revised protocol. However, as the cost of a facilitator would be met by the airport operator and airlines, the CAA would only appoint a facilitator following a request by the HAL or a significant number of airlines at Heathrow. This reflects the approach recently adopted by the CAA at Stansted.

Agreement on any updated information protocol is the preferred outcome. However, if HAL and the airlines cannot agree, it is open to either party to leave issues to be considered by the CC under the Enterprise Act or by the CAA which, depending upon when they arise, could be at the time of any mid-quinquennial review or as part of the Q6 review.

HAL is currently subject to a number of important obligations not to discriminate unduly between its airline customers, or to affect adversely competition. Effective consultation is likely to play an important role in HAL ensuring that it meets these obligations, as it affects the degree to which its decisions are appropriately informed. In this respect, an updated information protocol, covering issues of discrimination, could usefully supplement HAL's compliance processes.

HAL's current legal obligations do not, however, require it to secure the unanimous agreement of the Heathrow airlines prior to making any agreement or embarking upon any practice. Whilst it is obviously desirable to minimise disagreements between parties, such as on airline relocation plans, obliging HAL to obtain unanimous agreement might not further the reasonable interests of airport users, nor be achievable in practice. In this regard, the CAA notes that – alongside consultation arrangements – section 41 of the Airports Act and general competition law provide important protection to airlines and passengers.

Frequency of service quality audits at Heathrow

The CAA's March 2008 Heathrow decision committed the CAA to commission audits of the SQR at the end of 2008/09³ and in 2011/12. The CAA also reserved the right to initiate additional audits, depending upon the results of the initial audit.

As a result, the CAA's Heathrow decision allows for the possibility of a change from two audits during Q5 to annual audits and does not, therefore, prevent the CAA from adopting the CC's preferred approach.

Consequently, the CAA will consider the arguments put forward by the CC, alongside the results of the first audit and the views of stakeholders, when deciding upon the timing of subsequent SQR audits, in line with the March 2008 decision.

² Whilst the CAA reserves the right not to accept any airport-airline agreement as a replacement for the Q5 information protocol it has not, at this stage, identified any reasons why it would choose not to do so.

³ Steer Davis Gleave was appointed to undertake this audit, and commenced work in April 2009.

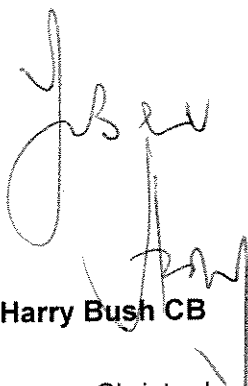
Next steps

HAL should now enter into discussions with its airline customers to agree a way forward. This should include inviting airlines' views on: whether and how the current information protocol should be updated; the process by which any update should be considered; and whether a third-party facilitator should be appointed by the CAA.

To support this process, the CC has announced its intention to secure undertakings from BAA that oblige it to report back to the CC on the progress made to agree an update to, and extension of, the Heathrow information protocol. In addition, the CC reserves the right to move towards issuing an order, obliging HAL to act in accordance with an updated information protocol.

If you have any questions about the issues raised in this letter, please contact James Mackay on 020 7453 6233.

I am writing a similar letter to Tim Hawkins and Jim Hunter.



Harry Bush CB

cc: Christopher Clarke, Competition Commission
David Hart, Department for Transport