

Great Britain: Regulation and Break-up of the BAA "London Monopoly"

The British airport company, BAA, experienced a fundamental evolution last year when it was taken over by the Spanish group Ferrovial (building and public works sector). BAA, which runs seven UK airports, which combined handle nearly 65 percent of all air passengers entering or leaving the UK. Consequently, this Spanish takeover can have a big influence on the British way of doing business. This article looks from a regulatory point of view at the Break-up of the BAA.

By Nadège Chapier-Garnier

BAA (British Airport Authority) was initially protected by two classic mechanisms introduced by the United Kingdom (and widely spread over the European Union, OXERA, Special rights of public authorities in privatized EU companies: the microeconomic impact, Nov. 2005, Reported for the European Commission, <http://ec.europa.eu>, 98 p.) in order to allow the government to intervene in the company's decisions, despite its privatization. These mechanisms were, on the one hand, a "golden share" by which preliminary authorization of the government was required for different types of decisions, and, on the other hand, direct special rights permitting an influence over the shareholder structure.

The European Court of Justice ruled that legislation which deters potential direct investment restricts the freedom of capital movement and establishment provided by the EC Treaty. The scheme that was adopted constituted an infringement of EC Treaty provisions (ECJ, 13 may 2003, C-98/01, Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland) and was dismissed. The company capital structure was a watered capital, and this left BAA vulnerable to a hostile takeover, which eventually took place in July 2006, as mentioned above, after several months of strategic action by both parties. Of course, this takeover could not be ignored by public authorities in Great Britain.

BAA is a "crucial" operator of the British airport sector, and, beyond that, of the air transport industry (M.-A. Frison Roche, "Proposition pour une notion : L'opérateur crucial", *Le Dalloz* [Paris], n° 27-2006, pp. 1895-1900 ; N. C h a p i e r - G r a n i e r - G r a n i e r, "L'OPA sur BAA ou les limites d'un modèle historique de privatisation d'aéroport", *Revue française de droit administratif*, Dalloz [Paris], n° 6-2006, pp. 1175-1183).

BAA handles 60 per cent of air transport passengers in Great Britain through its three London-area infrastructures (Heathrow, Gatwick and Stansted), carrying 90 per cent of the traffic in this zone (the remaining 10 per cent is handled at the Luton airport, a public infrastructure under private operation). BAA's integration into an industrial group with its own strategic agenda was worrisome to British authorities, though they could not directly oppose this capitalistic evolution. They reacted therefore in a more indirect manner, though this reaction has taken on an importance



which makes its adaptation in France difficult to imagine.

In fact, the Office of Fair Trading (OFT) has taken over this dossier since last spring. Its sphere of jurisdiction allows for a wide range of possibilities, as it is charged with ensuring that markets be permitted to satisfy consumers correctly. It is thus authorized to launch market studies to identify failings in market mechanisms that stem from causes such as competition, prejudice against consumers or the analysis of results of regulation. This is precisely what was done by the OFT in the case of the airport market, with BAA's predominant market position in its sights.

The results of that study have come out in the form of a report (Office of Fair Trading, UK airports, December 2006, 143 p., <http://www.offt.gov.uk>). It is necessary to remember, and it is with regard to this information that the OFT conducted its analysis, that in December 2003, the British government defined an overall policy aimed at expanding its airport capacity during the next 30 years in order to satisfy a demand which, according to predictions, will double during that time (Department for Transport, The Future of Air Transport, Dec. 2003 ; A. Graham, "Comparative political economy and infrastructure performance: The case for airports", 2006, <http://www.fundacionrafaeldelpino.es> [reuniones]). The purpose of the report is therefore to examine whether the current characteristics of the airport market permit this objective to be reached.

Initially, the report discusses the geographic delimitation of the three identifiable markets of the British airport service: the Scottish market, the northern England market, and the southeast market, which includes the London airports cited. Three characteristics of the current organization in this last area, for which the report was particularly awaited in view of the consequences for BAA, were suspected to affect competition. The first two, which concern problems of service infrastructure development and problems posed by regulation, do not depend directly on the operator. The third concerns it directly: the OFT deems that the fact that the London airports are held by a single operator seems to undermine market function. This stems from multiple factors which indicate that potential competition between these three airports would be stifled by their single ownership. The report points in particular to the fact that the monopoly would weigh heavily on investment decisions whereas this question is central to the criticisms of airline companies (insufficiency or inappropriate character).



The OFT announced, in view of these elements, its proposition to refer the matter to the Competition Commission, which, if the process is to be continued, will conduct its own inquiry and will be obligated to take appropriate measures to end whatever problems it may uncover. These measures may go as far as the break-up of a monopoly judged to be harmful, a solution envisaged by the OFT report (another maneuver being to make changes in the legislation). Stakeholders gave their response to the OFT's analysis, according to the relevant procedure. The different positions expressed were expected, as the relationship between airports and their users is often a conflicting one since the liberalization of air transport (N. Chapier-Granier, *Les aéroports commerciaux entre économie administrée et économie de marché – Aspects juridiques d'une mutation*, Presses universitaires d'Aix-Marseille, 2006, 626 p.). Airlines criticized the management of BAA, stressing investments unsuitable for their needs. BAA tried to underline the lack of a market study (BAA/OFT/73, February 2007,

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<http://www.offt.gov.uk>). Even if the operator admitted that the airport sector "deserves study", development/capacity and regulation issues are mainly outside of its control. So, the break-up of the London monopoly will not offer any real solution from this wider scope, according to its analysis. In addition, BAA disputed the soundness of explanations and evidence provided in the report, which weaken its positions, so the operator refused to offer undertakings in lieu of a reference. A break-up is then conceivable if the Competition Commission follows the investigations. Certainly, this watchdog has imposed quite important structural remedies in the past, as shown in the case of the British Gas monopoly, but



this dossier would give rise to the first application of the powers which were redefined by the Enterprise Act 2002 in such a complex context of monopoly (P. Freeman, "Regulation and Competition – Chalk and Cheese? The Role of the Competition Commission", CRI Frontiers of Regulation Conference, University of Bath, 7 September 2006).

Furthermore, the deeper integration of BAA into the market economy offers some interesting lessons from several perspectives. A first period has focused on the improvement of the regulation process, as far as the review of fundamental options (D. Starkie, "Reforming UK Airport Regulation", *Journal of Transport Economics and Policy*, Vol. 35, Part 1, January 2001, pp. 119-135). The takeover ushered in a period that will propose inventive solutions to satisfy the market discipline. Thus, it is interesting to note that a classic scheme of the liberalization of public utilities, unused in the airport sector, could find an application with BAA, but not for the same purposes. As a matter of fact, Ferrovial considered dividing BAA in two and grouping together the activities submitted to price cap regulation by the Civil Aviation Authority. Even so, this control is a source of tension (the price proposals by the CAA in May 2006 with the cut of BAA's return on capital is a typical example: <http://www.caa.co.uk> [Quinquennial reviews of Designated Airports]). It represents a secure business with recurring revenues that could "command a higher debt rating than the company as a whole" (Reuters, 4 December 2006, <http://www.reuter.com>). Questions remain as to the capacity for this plasticity – commanded by the market – to protect public interest, and regarding wider political issues like sustainable development.

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